

## Recent trends in legal studies in the framework of energy policies

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Energy policies in Europe have undergone major changes in the last 30 years. It is therefore no big news that the research interests of the legal academic world have mirrored such changes. So, for instance, at times when in the EU, the Internal Market imperative was not affecting services of general economic interest, such as energy, most doctrinal contributions were devoted to industrial policy and public intervention in the economy, and most legal scholars advocated the importance of protecting national champions, of having public ownership, mid-term planning and of attributing exclusive rights.

When, in the late Eighties, the EU championed liberalisation and the free movement of services, including electricity and gas, the legal doctrine devoted much research effort to competition law and policy and embraced in a thorough debate on how to match competition with social goals, such as the need to ensure a universal energy service. Neo-liberal economic regulation in Europe supplanted industrial policy and its tools, such as planning, control over market structure and legal monopolies; and scholars started depicting the EU much as a regulatory state (Majone 1994).

The financial and economic crisis, however, has showed how fragile the policies promoted in the past were. Indeed, a great part of the most recent pieces of EU legislation attaches much importance to the goal of attaining greater energy efficiency, on the one hand, and to state aid support of energy firms (especially to build smart grids) on the other.

In the scholar debate, a new 'statist literature' is developing (Thatcher 2014), claiming for a 'resurgence' of state intervention, with central actors playing a direct role in leading the economy, although in a framework of resilient neo-liberalism (Shmidt-Thatcher, 2013).

This literature makes three essential claims.

Firstly, liberalisation has not meant any complete retreat of the state from the energy markets; quite to the contrary, state intervention has mainly changed its form (e.g. independent regulatory authorities supplanted ministers in the oversight of energy sectors; central planning found its substitute in regulation of security of energy supply; the setting of tariff is now understood as rate of return and price-cap regulation) (Cassese). In addition, and quite paradoxically, liberalisation resulted in an increased (re-)regulation of energy sectors (Vogel 1996).

Secondly, while implementing EU legislation, states have engaged in 'selective' liberalisations, meaning that energy markets were open to competition in ways to support domestic incumbents. Even antitrust law, when applied to energy markets, embarked in the difficult task of balancing the need to foster competition with the need to aid 'Europeanised or internationalised champion firms' (Thatcher, 2014, p. 22).

Thirdly, and most evidently, the 'statist literature' has created a theoretical and cultural environment that facilitates the support for state intervention in the economy and, more specifically, in the energy sectors.

One of the fields where the 'resurgence' of state intervention has increased in the recent past is energy consumer protection. Early EU Directives and Regulations of the late '90s purporting the

liberalisation of energy markets, were mainly focused on the supply side. Under their terms, exclusive rights for the production and resale of gas and electricity were outlawed. Moreover, unlike the US, where vertical integration of energy utilities was left untouched, liberalisation in the EU unbundled transmission and distribution networks from other energy activities, and being natural monopolies, subject them to price regulation. Access to such networks was made binding to allow downstream competition to work; while vertically-integrated energy companies were forced to legally separate their activities and keep separate accounts to avoid cross-subsidisation.

The demand side, on the other hand, was relatively neglected. The prevailing neo-liberal thought stood on the idea that allowing – yet, liberalising – the demand to choose the provider they preferred, would automatically create a competitive pressure on energy firms. In a hypothetical energy internal market, Italian final consumers would opt for a Dutch provider, thus forcing Italian retailers to compete and thus become more efficient.

Sure, there were norms in these pieces of legislation that considered consumers' interests, such as the rules concerning public or universal service obligations. However, the underlying rationale was mostly one of finding the right balance between existing doctrines of 'service public' or 'servizio pubblico', on the one hand, and the need to open markets to European and international competition, on the other. In brief, such norms were not focused on consumers' effective and real needs.

It is only right before and after the start of the crisis, that rule-makers began realising that final consumers could become vulnerable in a fully liberalised energy market, or worse, energetically poor.

With the second and especially the Third Energy Package of 2009, the EU embraced the 'consumer protection bandwagon', and adopted legislation aimed at strengthening the position of final customers (i.e. the demand side), as opposed to previous policies, that were mainly focused on the supply side, to promote competition in previously monopolised industries.

Of course, the Italian legal doctrine has mirrored the shifts of focus succinctly described, and my presentation will deal with this latest trend, to highlight the emergence of a totally new and innovative way of enhancing consumers' interests by regulating their behaviour.

Consumer law in Italy, and I would say in Europe as well, has been highly dependent on the liberal theoretical framework that had prevailed since the 19<sup>th</sup> Century. Rules concerning consumers were no different from rules regarding any contractual party. As the rationalist paradigm was the prevailing theory, there was no need to foresee any special rule. Consumers were seen as rational actors in the market, and their free will (their 'autonomia negoziale') was the sole source of judgement of their own welfare. That of the rational 'consumer sovereignty' was seen as the sole possible paradigm to enhance consumer welfare in a market economy. Under the 'consumer sovereignty' doctrine, individuals are regarded as the best judges of their own needs and should be allowed to take their own decisions away from State intervention. The argument goes that being informed and rational, citizens are able to make appropriate choices. Therefore, markets are the best allocator of welfare, and individual choice is the best discipline

for markets (it follows that individual preferences should be left untouched). Public intervention, in turn, should act as a mere facilitator of private choices and market forces <sup>1</sup>.

Under this scheme, no disclosure requirements or obligations to consume any goods (e.g. seat belts) should be enacted, as State paternalism <sup>2</sup> would result, entailing the denial of consumer sovereignty: laws recognising individual rights <sup>3</sup> are not meant to orientate individual choices, rather they are put in place to strengthen their autonomy and to allow for autonomous and (supposedly) rational decisions.

Against this paradigm, the Italian doctrine, in the late '70s started theorising that consumers were weak parties in commercial contracts, and that some legal tool was needed to re-balance their contractual position (Alpa). Despite these efforts, it is only in the '90s that the Italian legislator, under the pressure of European institutions, started to introduce norms specifically designed for weak consumers. So for instance, in financial markets, binding pre and post contractual transparency obligations were introduced for financial intermediaries, and rules of conduct for the latter were also established in an aim to protect private savers.

Great parts of such law were justified on the basis of the economic concepts of information asymmetry, or of unequal contractual power that favoured firms to the detriment of consumers. In energy markets, as already mentioned, it is only from 2009 that specific rules to protect 'vulnerable consumers' are envisaged. And in 2010 the European Commission introduces the idea of 'consumer empowerment' as a goal to attain a complete and working Internal Market for energy. As far as vulnerable consumers are concerned, the EU law leaves member states free to define those users that fit the category, and in favour of which they are bound to introduce protecting measures. Vulnerable consumers, however, are mainly defined as those that are in disfavoured socio-economic conditions, such as the poor, the elders, and those that are left without provider (e.g. because of exit from the market).

Concerning empowerment, in 2010 the Commission started investigating the reasons why consumers tended to be inactive in the market, and developed a 'Consumer Empowerment Index' to help member states measure the effectiveness of instruments adopted to enhance consumers' position. Consumer empowerment in the field of energy included the presence of consumers'

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<sup>1</sup> The liberal view puts individuals' sovereignty at the centre and encompasses consumer rationality: the market is the best allocator of welfare and individual choice is the best discipline for markets. Rational and self-interested choices thus induce more efficient production, cheaper and better products, etc. Some author would account this as "empowered consumers": J. Denegri-Knott, D. Zwick, J.E. Schroeder, *Mapping consumer power: an integrative framework for marketing and consumer research*, European J. of Marketing, 40:2006, pp. 950-971.

<sup>2</sup> J.E. STIGLITZ ET AL, *The economic role of the state*, Oxford UK, Cambridge MA, Blackwell, 1989. N. IRTI, *Ordine giuridico del mercato*, 1998

<sup>3</sup> In this rather outdated liberal view, the best way to protect citizens is to entrust them with rights and corresponding action: anytime they deem their rights are infringed they may place a lawsuit; this is the case with antitrust private enforcement, or contract breach complaints. An example is provided by the Italian Consumer code (legislative decree no. 206 of 2005), which Art. 2 recognises the following rights: health, security and quality of any product; adequate information and fair advertising; fairness, transparency and equity of contractual relationships; promotion of freedom of association; provision of public services according to defined quality standards.

points of contact for complaints, of ADRs for easy access to dispute resolution, of pre and post contractual disclosure obligations imposed on energy providers, and of tools that simplify comparison among different commercial offers existing in the market. Furthermore, an ad hoc forum grouping national regulatory bodies, EU and nation-wide consumer protection institutions, as well as the EU Commission, was established in London (it is the so called London forum), with an aim to exchange best practices in the domain of consumers' empowerment. On June 8<sup>th</sup> 2015, the EU's 28 Energy Ministers forming the Energy Council, met in Luxembourg and explicitly affirmed that:

«the goal of the EU's plans for Energy Union must be to provide consumers with affordable, safe, competitive, secure and sustainable energy».

In this context,

«the Commission announced the adoption in mid-July of two initiatives on a new market design and a retail market which would put consumers very much at the heart of the Energy Union».

«Ministers identified certain weaknesses in the EU's energy system, notably ... the need to help consumers in vulnerable situations and to ensure that consumers are fully informed on the possibility to control their energy consumption using smart technology».

Yet, all these efforts missed something that scholars in fields other than law were theorising since the 50's. I am referring to the seminal work of Herbert Simon "A Behavioral Model of Rational Choice" of 1955, that is recognised as the alpha of behavioural economics. Attention is given to 'real' persons, and therefore real consumers: the observation of human behaviours does not confirm the rationalist hypothesis. Rather, human behaviour shows systematic deviations from hypothetically rational choices. These deviations are so widespread to allow Nobel Laureate Daniel Kahneman, together with Tversky, to draw the 'Maps of Bounded Rationality' (Nobel Lecture 2002).

Since the **pioneering work of Simon**, cognitive sciences (which draw insights from psychology, behavioural economics, sociology and neurosciences) have **challenged the rational assumption**, showing that in the real world, people often **procrastinate their decisions** or decline to make the effort to rethink decisions; they are **influenced by how things are presented**; they tend to be bad at anticipating the future, for instance, by caring more about present losses than future gains; **they care about what other people think** of them and **tend to conform to their peers' choices**.

As Simon pointed out information overload consumes people's attention, as their cognitive resources are limited, making them unable of processing the huge amounts of information that is necessary to decide. Choices are indeed guided by heuristics and conditioned by cognitive biases, such as 'status quo', meaning that energy consumers may prefer not to change their provider because they are 'used' to it, even if switching could save them money.

Another example is the 'present bias', meaning that people prefer avoiding a loss rather than making a profit. Energy consumption generates utility in the present, while its costs are only known weeks after, namely when the bill arrives. Moreover, 'loss aversion' may explain why consumers do not spend their money in making their homes more energy efficient. Indeed, while consumers immediately perceive the costs, savings are only visible in the future (this is also known as the energy paradox).

Information, as already mentioned, may cause confusion if it is given in a technical way or if it is excessively abundant. Another factor to be considered is the 'framing effect': decisions are

influenced by the way in which options are presented, or by the way information is made 'salient'.

Many of the bias and heuristics described might affect energy consumers' and thus shape their behaviour. However, unlike economists, so far jurists have paid very limited attention to the insights coming from cognitive sciences and to the experimental literature.

The two research paths – that of cognitive scientists and of jurists – tend to ignore each other. They do cross sometimes, but only occasionally and in a non-systematic way. An example at EU level is the JRS booklet Applying Behavioural Sciences to EU policy making of 2013, or the recent Behavioural mapping initiatives, aimed at recording efforts by national regulators to make use of cognitive and behavioural insights in performing their tasks.

It is my personal belief that this literature has a lot to tell to the legal scholar, especially because it questions the very basis underpinning concepts such as 'autonomia negoziale' and 'consumer sovereignty'. Refraining from considering how real people decide and behave does consequently question the validity of the many tools rule-makers have designed to both empower and protect weak consumers. In my view, jurists should consider that consumers may be weak also because their behaviour is affected by some cognitive and behavioural limitations, and not just because they are old, poor or internet illiterate. These reactions are **not irrational, nor** are they "**wrong doings**" or **deviations**, as supporters of neoclassical microeconomics contend. Indeed, biases are not anomalies and exceptions to rationality (even if they are systematic). Quite to the contrary, **they are just part of normal behaviour**, as **modelled** by the **brain** and **conditioned by personal attitudes**, the **socio-cultural context**, the **institutional environment**, and the **interactions** among them.

What is most important for rule-makers, is that these reactions might lead regulation to fail. Regulation that is designed to empower consumers, such as disclosure mandates, may fail to help energy consumers be active in the market because they make energy contracts excessively complex to understand. Such mandates may fail helping consumers to choose the best provider in the market, because most consumers in the relevant market are affected by status quo or procrastination biases. If the regulator ignores what the possible reactions of regulatees might be, then even the most sophisticated regulation might fail attaining its goals. In legal terms, this means that the public interest for which that regulation was enacted in the first place, remains unprotected. And the risk of 'irresponsive behaviour', meaning behaviour that does not correspond to what rule-makers expected by their intervention, is something they should care a lot about.

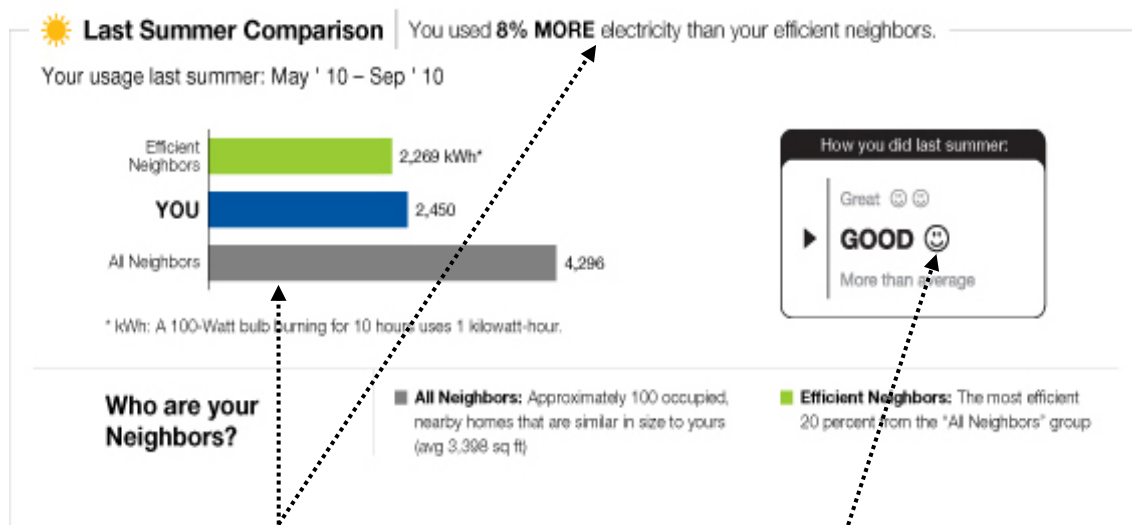
Another example is energy efficiency. Directive 2012/27/UE requires national regulators to oblige retailers to provide consumers with many pieces of information aimed at increasing their awareness about energy consumption and costs, and allowing optimal uses of energy.

In particular, consumers shall receive data on their historical consumption rates in the last 3 years; detailed consumption data of the past 2 years; information on prices offered by different retailers; comparison between energy consumption in the current and the same period of the past year, preferably using graphs; practical tips on how to increase energy efficiency; and 'relational information' meaning comparison between one's consumption with that of a reference average consumer group; forecasts on energy costs, that are easily understandable and that allow consumers to compare different commercial offers.

Simple disclosure of information on energy consumption, even if frequent and disaggregated, is not sufficient alone to change consumers' behaviour. What regulation should do is to motivate a change in behaviour (for instance, by setting specific objectives, not just by providing generic 'do your best' or 'respect the environment' warnings). Regulator could do so, and thus change the 'reference point' of consumers, by leveraging, for instance, on social norms.

My contend here is that in order for such measures to be effective, thus saving administrative resources, the regulator should test those in advance using cognitive experiments, such as lab or field or neurologic experiments. This investigation, much more than traditional audits or notice and comment, would allow the regulator to gather information on possible reactions of energy consumers. Using experiments, although costly, would allow, as said, to avoid regulatory failure that would result, e.g. if too much information is provided. It would also help regulators to choose, for instance, the most motivating frame or the right frequency for information disclosure. A cognitive-based regulatory process, that is, one that includes experiments, might also help to discover whether the target population is affected by 'inertia', meaning that despite the information received energy consumers choose a bad deal and after that bad experience do not switch their provider.

As reported by Sunstein and Thaler in their much renowned book 'Nudge', there is empirical evidence showing that 'relational information' proves very motivating in inducing energy efficient behaviour and overcoming inertia.



'relational info' (feedback)

Exploiting emotions  
(boomerang effect)

Source: Opower, City of Pasadena 2014

Evidence also shows that the more consumers identify themselves with the reference group, the greater the effectiveness of relational information is in inducing energy efficient behaviour. A field experiment conducted in Jerusalem by Dana Ritov, Nicolao Bonini et al (and whose results were presented last week in Rome), has deepened the knowledge on how much similar the referent group should be not to cause alienation (a boomerang effect).

This new branch of legal scholarship is only at its outset, although it has already attracted much criticisms. Most detractors are reluctant to abandon the reassuring idea of consumer sovereignty and of rational choice; other see manipulation and big brother attitude as a risk to avoid at all costs, including that of protecting a notional, hypothetical and unreal consumer.

I want to close this presentation by quoting Vincenzo Roppo, one of the most renowned Italian civil lawyers. In his recently published book 'The dumb law', Roppo warns us that «the rational law of the enlighten men is no omega whatsoever. It is the most noble of all illusions; no more than a step to which other unforeseeable stages will follow».