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# WSBF Roundtable 14<sup>th</sup> May 2019

## Better Utility Regulation

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### Top Lines

- **Views in Westminster with regard to the future of the utility sector are polarized.** The approach taken by the current government is to push regulators to toughen up their interventions and 'prove' the existing regime works. Labour has proposed re-nationalisation of the water and energy sectors.
- **Integrating systems can address many of the problems faced by individual companies.** The Systems Regulation Model (SRM) developed by Professor Dieter Helm, proposes the setting of prices through markets and the provision of public goods through system plans.
- **The current 5 year price review system is inappropriate for addressing long-term issues.** Challenges in the utility sector such as achieving net zero carbon emissions, combatting loss of biodiversity, and improvements on the catchment-scale cannot be solved by thinking in the short-term.
- **Rapid changes in technology will present a new set of challenges for consumers.** Early adopters tend to benefit from these changes however, most consumers are slow to embrace new technology and vulnerable customers can be left behind.

### Recommendations

- **It should be for Government to decide what kind of systems it wants.** Big decisions should be made at the national level. This way, multi-generational issues can be addressed and trade-offs (such as between consumers and the environment) can be appropriately balanced.
- **Regulators should acknowledge common work areas between sectors and liaise with each other.** The importance of communication between systems will only become more important in future and efficiency savings can be made by working together.
- **Government needs to think in the long-term.** If it can be demonstrated that fulfilment of a long term goal (such as the 25 year environment plan) will be economically better than the alternatives, then cross party consensus can be achieved. The 5 Year price review system doesn't allow political parties to sign up to a bigger vision as to how infrastructure can be built.

## Introduction

On 14<sup>th</sup> May, the Westminster Sustainable Business Forum (WSBF) convened a roundtable to discuss how the regulation of utilities could change in the future as we move to a lower carbon, smarter and more resilient system. The roundtable was chaired by **Maxine Frerk**, Director at Grid Edge Policy.

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## Speakers

### Professor Dieter Helm CBE, University of Oxford

Professor Helm opened the roundtable by outlining his ideas on a future regulatory system for utilities, building on his recently published Systems Regulation Model (SRM).

- Utilities in the UK (including the water, gas and electricity networks) are regulated under the 'RPI-X' price-cap system, where price increases are limited by the relevant regulator (such as Ofwat or Ofgem).
- Regulator reform is inherently difficult to achieve. Current and past governments have adopted the approach of 'if it isn't broke, don't fix it'.
- There have been some successes to RPI-X over the past 30 years. It brought down operating costs and relieved constraints on the treasury's overall capital programme. However, moving from a 'pay as you go' to a 'pay when delivered' system passes on costs to future generations.
- The post-war mind-set, adopted during the 40s, 50s and 60s was that each generation passed down a set of infrastructure assets to the next. However, the current system doesn't do this.
- We need to think beyond the current 5 year price review system and consider what we want regulation to look like over the next 10-30 years. Our infrastructure faces 'system' questions that go beyond the domain of individual companies. For example, catchment systems within the water regime incorporate supply, sewage, flooding, farm management and rivers. Moving to a SRM integrates these systems and addresses many of the existing problems.
- Professor Helm's model offers an alternative to both the existing system and Labour's proposals for nationalisation of the water and energy sectors. The SRM proposes the setting of prices through markets and the provision of the public goods through system plans.
- Integration of systems can help to solve many of the most pressing issues in the utility sector including: how do we achieve net zero carbon emissions, how do we improve our catchments, and how do we deliver broadband and telecommunications infrastructure to the country as a whole?
- It is ineffective to leave regulators to decide what the systems should be and boards of directors to decide what business plan needs to be in place to achieve that system. . We currently approach this as a planning problem and not a regulatory problem.

- Business plans should not be defined on a 5 year fixed price contract. It should be for Government to decide what kind of systems it wants and then for the system regulator to auction out the component parts of what's required.
  - In this framework, the cost of capital comes through the bids auction. The current system sucks in regulators to greater and greater levels of involvement. Otherwise it becomes a race to the bottom, with a fixed cost of capital.
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### **Rich Sullivan-Jones, National Audit Office**

- The National Audit Office (NAO) has no role to assess policy, rather it assesses how current policies are put into practice.
  - The NAO's recent report (*Regulating to protect consumers: Utilities, communications and financial services markets*) focused on how regulators set out what it is they are trying to achieve, how they manage trade-offs and whether they have a good understanding of their own performance and impact.
  - One challenge for regulators is to determine who is responsible for making high-level decisions and to consider trade-offs that could arise. For example, there can be trade-offs between current vs future consumers, or between things that are good for consumers vs things that are good for the environment. These issues are complex for the regulator to solve and often not within their remit, and therefore require Government input and direction.
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### **Rt Hon Lord Whitty, House of Lords**

- Vulnerable consumers tend to fare badly when suppliers have a monopoly but their problems are not solved by more competition. For example, currently only 30% of energy consumers actively switch their suppliers and problems arise both with long established companies and challengers. . Both customer service and price are issues that need to be addressed in any regulatory framework.
  - Technology change will present a different set of issues for consumers. Currently, only a small number of consumers control their energy digitally (such as via a mobile app) and these kinds of changes tend to benefit early adopters but not most consumers, especially the vulnerable. This too needs addressing in the regulatory framework.
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### **Dr Jeff Hardy, Imperial College**

- Consumers have articulated what they want in a low carbon transition. An environmentally compatible, equitable and just system is a priority but consumers also demand improvements. There is a real possibility that things could end up being the same, but just more expensive.
- We should create space for companies that are able to bundle services together. One option could be a move away from prescriptive regulation and towards risk-based regulation. For example, a

company declares its activity and is risk assessed on this basis. They pay an insurance premium against any harm that they could cause to the system.

- In a world where products are bundled, it doesn't make sense to have consumer protection regulators siloed within sectors. The functions of regulation are quite common, so efficiencies can be made through working together.
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## **Alena Kozakova, Ofwat**

- Ofwat does not share Professor Helm's view that everything is so badly broken that it needs completely rethinking.
  - Ofwat are putting greater emphasis on the environment and public purpose than they have in the past and have been exploring different angles, such as direct procurement. They do feel the need to justify the impact that they are having and use targets to measure their progress.
  - It's important not to overstate problems with the five-year price review system: it has delivered some improvements in sustainability and service.
  - Ofwat acknowledges that other regulators do have similar duties and they are being more proactive in liaison.
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## **Discussion**

- Professor Helm clarified that in his model, architects should be government, not companies. The system regulator has to ensure that plans for systems are carried out (such as a catchment plan). They would then open up bids for a solution that they want to achieve (i.e. a goal for a flood management objective for a specific watercourse).
  - Communication between systems is made worse by siloed government departments. Communications is the most important part of each set of infrastructure (big issues, such as cybersecurity or projects like HS2 cannot be left to individual organisations). These decisions have to be made at the national level.
  - The question of 'what do we want?' is often easy. However, the means by which we get what we want can be more problematic. We need an institutional way to allow political parties to agree, without losing face. The 5 Year review system doesn't allow political parties to sign up to a bigger vision as to how infrastructure systems can be built.
  - Residual regulatory functions such as consumer administration and consumer affairs could be consolidated into a single body. The government could create a system plan (for example a catchment plan for the Thames) and the system regulator has to ensure that the objectives of the system plan are achieved.
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## About the organisers

The Westminster Sustainable Business Forum (WSBF) is a high-level coalition of key UK businesses, Parliamentarians, Civil Servants and other organisations. Providing a politically neutral environment for knowledge sharing and discussion on sustainability policy, we help to inform the wider sustainability agenda in government and are a trusted source of independent information and advice for policymakers. We publish authoritative research reports; impact on government policy through our in-depth round table policy discussions and outputs; and inform the wider sustainability debate by convening Parliamentarians, senior Civil Servants, business experts and other stakeholders at our larger policy events and seminars. The WSBF works in the policy areas of construction, infrastructure, water, sustainable planning, green finance and natural capital. We are cross-party, independent and not-for-profit.

For more information on our activities, please visit: [www.policyconnect.org.uk/wsbf](http://www.policyconnect.org.uk/wsbf) or alternatively please contact Rob Allen [rob.allen@policyconnect.org.uk](mailto:rob.allen@policyconnect.org.uk).

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