

# Encouraging Innovation in Utilities

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## Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 100 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership covers over 90% of both UK power generation and the energy supply market for UK homes. We represent the diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 27 million homes and every business in Britain. Over 680,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry invests over £12.5bn annually, delivers around £84bn in economic activity through its supply chain and interaction with other sectors, and pays £6bn in tax to HMT.

This is a high-level industry view; Energy UK's members may hold different views on particular aspects of the consultation. We would be happy to discuss any of the points made in further detail with HM Treasury or any other interested party if this is considered to be beneficial.

## Executive Summary

New, innovative products and service offerings have the potential to enthuse and excite the consumer, providing new avenues to market engagement that help achieve a low carbon energy system delivering excellent service, choice and value for money to all UK's homes and businesses. We cannot, and should not, attempt to second-guess exactly how consumer expectations will evolve alongside technology. However, we are already beginning to see new service offerings being taken up by consumers, such as innovative EV tariffs, choosing smaller community generators, or securing the lowest possible cost for electricity supply on an ongoing basis.

Data will be at the heart of these new, innovative approaches to engage consumers in the energy market and needs to be effectively harnessed. It will, therefore, be important to have the most efficient regulatory regime in place to ensure appropriate access and protections are in place, and hold accountable those making use of this proliferation of customer and system data. These data-driven or enhanced services or products will not be limited to energy alone so it will be important for Government, regulators and industry to think cross-sectorally when designing governance and market structures.

We believe that competitive markets will deliver the best results for consumers through innovation and adaptation to evolving consumer demands. The Government must ensure that the energy sector remains a safe and reliable place to invest in order for the full benefits of new technologies and methods to be realised for the consumer. Energy UK does not consider that a new statutory duty to encourage innovation is the answer or that it would provide a benefit to consumers, market participants and potential innovators as such a duty is already implicit within Ofgem's current duties, as evidenced by their actions to date in encouraging innovation.

## Understanding the Barriers and Opportunities for Greater Innovation

### ***What barriers, if any, are there to development and implementation of innovative technologies and methods in the utilities sectors?***

#### *Regulatory Certainty & Independence*

The UK needs to remain a safe and reliable place to invest in order for market competitors to continue to feel confident to innovate in the energy sector. An unreliable and opaque regulatory regime could risk the innovation and investment that is needed to realise the full benefits of the energy system transition that is underway. As part of this the Government will need to ensure that the right balance is struck between intellectual property protections to encourage innovation and customers receiving the benefits.

To attract the necessary investment that fully enables the development and implementation of innovation across the whole of the energy system it is paramount that the Government remains committed to an independent and authoritative regulator, in line with the CMA's Energy Market Investigation recommendations. The CMA found that a lack of robustness and transparency in regulatory decision-making increases the risk of policy decisions that have an adverse impact on competition in the energy market. The Government should, therefore, make a renewed commitment to proper scrutiny of regulatory decisions which improves decision-making and helps to sustain investor confidence.

In practice, this means a commitment to appeals on the merits to an expert body, as well as Judicial Review. It is widely recognised that good regulatory decisions are most likely where the regulator itself can be challenged, as regulators are not infallible and may not always have recognised the scale of the impact of their decisions on specific parties (including customers). With new technologies and business models it may also not be reasonable to expect Ofgem to have insight into the impacts of all changes on all parties.

#### *Supplier Hub Model*

The current supplier hub model successfully sees suppliers providing a single, easily understandable and recognisable interface for the consumer to ensure that: system costs are settled; wholesale risk is managed on behalf of consumers; consumption is metered; social and environmental obligations are collected and delivered on behalf of government; and that there has been a conduit for consumer protection. However, some elements of the central role that suppliers are currently mandated to fulfil are being challenged by evolving consumer expectations and technological advances. New retail entities or propositions may not be able to interact effectively with wider energy systems and back-office arrangements, such as the challenge of peer-to-peer models and the inability to have multiple suppliers servicing a single consumer.

Ofgem has already begun to review the future of the supplier hub model through its future supply market arrangements workstream. Following an initial call for evidence, Ofgem has concluded that there is a strong case for reforms to be explored and Energy UK looks forward to engaging positively with the project. In particular, Ofgem has decided to explore whether reforms could maximise the benefits that customers might see from the greater levels of innovation expected as the energy system transitions with smart meters and other significant projects. For example, one aspect of the supplier hub that is being assessed for reform is the current restriction on multiple suppliers to the same meter. Removing this restriction could have the potential to open the doors to innovative offerings that meet evolving customer expectations. However, any reforms identified through Ofgem's work will need to be rigorously assessed in context of the wider market structure and the implications, costs and benefits for consumers.

#### *Supplier Obligations*

Alongside Ofgem's review of the energy market structure, there is also a need for the Government to explore alternatives to the delivery and recovery of costs for programmes currently delivered through supplier obligations: with key programmes ending in the near future (smart metering roll-out, ECO), and new data sharing initiatives in place to identify vulnerable customers, supplier obligations should be fundamentally reviewed. Energy UK believes that such obligations are regressive, against the interests of all consumers and can create barriers to innovation if certain suppliers or service providers have the

added cost and administrative burden to deliver obligations that are best funded through taxation. The energy system is not an efficient surrogate for intelligently developed and delivered Governmental social and environmental policy initiatives. Such a move would be outside of Ofgem's control and it will take Government action to readjust its policy to remove these barriers to innovation.

### *Prescriptive Regulation and Industry Governance*

Energy UK has also identified the level of prescriptive regulation in both the supply licence and the various industry codes (MRA, SPAA, BSC, UNC etc.) that suppliers are required to comply with as a barrier to innovation in the energy market.

As identified by the CMA in its independent review of the energy market, the different electricity, gas and retail codes offer a complex, resource intensive regulatory framework which can be challenging for small and large companies alike. This becomes more challenging when multiple large changes occur across the energy industry in a short period of time without being fully considered in the whole across industry systems. We believe the framework needs to be simplified to help increase accessibility for all market participants, including disruptive new businesses and technologies. Ofgem and BEIS have recently launched a review of energy industry codes and we look forward to engaging positively with the workstream.

More broadly, any regulatory regime must be principles-based by default with targeted prescriptive elements where they are deemed necessary. Using this approach as the foundation a licensing regime would foster innovation and allow suppliers and service providers to better tailor their products and engagement activities to meet evolving consumer expectations. Retaining the overly-prescriptive and rigid licences will limit the ability of market incumbents and new entrants to innovate and adapt to changing consumer expectations and technology. To see the full benefits of such a change there will need to be an evolution in the way the regulator acts within the market, taking it from a central, prescriptive role to one more focused on supporting and fostering competition, whilst retaining strict enforcement powers to protect consumers.

In order to realise to full innovation potential in a smarter energy system, it may be beneficial to review the way in which all energy market participants are regulated. One possibility could be to move to a functional approach to licensing, whereby the regulator defines certain activities and if you carry them out then you are subject to those licencing aspects. Such an approach to regulation could foster innovation by reducing unnecessary administrative burdens whilst providing greater customer protections as any new service could be flexibly incorporated into the regulatory regime by Ofgem. In considering any such option, regard will need to be given to customers who are restricted from benefiting from new services or technologies to ensure that they are not left with an undue burden of costs. Energy UK believes that this could encourage innovation and greater cross-sector working. Ofcom use a similar functional approach by ensuring effective consumer protection and regulatory resilience whilst minimising the regulatory impact on any individual market participant to that which is proportionate for the activities they actually undertake.

### ***What are the best way(s) for utility regulators to further promote innovation in their sectors while ensuring the interests of consumers (present and future) are protected?***

Within the current regulatory framework, Energy UK believes that the reliance on prescriptive regulation is outdated and requires an overhaul. This is also why Energy UK has been supportive of Ofgem's Future of Retail Regulation programme which has most recently overhauled the previously prescription-based requirements for supplier-customer communications. By placing a greater reliance on principles-based regulation, we believe Ofgem can future proof the supply licence whilst also ensuring industry thinks more innovatively about how it can deliver good outcomes for customers.

### ***What barriers, if any, are there to innovative sector specific and cross-sector business models?***

As already noted, the current regulatory regime is characterised by a very large licence which all retail suppliers are required to apply for and then comply with if they wish to supply gas or electricity to domestic or business customers. A significant risk to a future retail market which seeks to attract new innovative businesses that may not have their principal interest in energy supply is that such a bureaucratic system will act as a barrier.

As more innovative and disruptive market players enter the market this approach is already becoming untenable. This is not a new concern and Energy UK has previously highlighted that changes in the routes of consumers' engagement with their energy requires a regulatory response, most notably with regards to Price Comparison Websites (PCWs) and the recent growth of automatic switching services.

The regulatory system will need to be set up to most efficiently monitor, support and enforce in a market that will likely see a growth in cross-sectoral offerings. Whilst we are not able to second-guess the availability of such products in the future, or their popularity with consumers, we can already see the potential for energy to become just one part of a bundled service. We risk a crisis in consumer confidence in such offerings if the regulatory regime is not aligned to best reflect the way in which markets are engaged and services are provided. For example, if a consumer purchased an EV bundled in with financing, insurance, product guarantees and energy supply, the regulatory system is not currently designed to act in the most efficient manner to deal effectively and consistently with a failure on the provision of one or more of these services. Some ideas are already being discussed to address this concern, which could be explored by the Government. For example, Laura Sandys and Dr Jeff Hardy's recent paper, *Redesigning Regulation*, has recommended the creation of one essential service consumer regulator.

### **Policy and Implementation**

***How have utility regulators most successfully encouraged innovation in their sectors?***

**AND**

***What additional tools and expertise, if any, do utility regulators need to respond to technological change and promote innovation in their industries?***

Energy UK believes that Ofgem currently has the tools and resources necessary to carry out their current duties. We believe that this is evidenced by the work it is already undertaking to encourage innovation within energy, such as its regulatory sandbox and the moves towards principles-based regulatory mentioned above.

### **Regulators' Statutory Duties**

***To what extent would a statutory duty to promote innovation help regulators focus further on encouraging greater development and adoption of innovation in their sectors?***

**AND**

***What other measures might support an innovation duty in helping regulators to focus on encouraging innovation in their sectors?***

Energy UK does not believe that a statutory duty to promote innovation would help Ofgem to focus further on encouraging greater development and adoption of innovation in energy. Such a duty is already implicit within Ofgem's primary duty to protect the interests of existing and future electricity and gas consumers.

As innovation should be for the ultimate benefit of the consumer, Energy UK does not believe that the Government has made a convincing case to impose a further statutory duty on Ofgem that risks it pursuing innovation for innovation's sake, risking consumer or market detriment. We would welcome clarity on the rationale behind such a suggestion, as the Government has not set out effectively the problem it is seeking to solve with a potential statutory duty to promote innovation. Energy UK is unconvinced that a further duty would aid in encouraging innovation and we note that the CMA's Energy Market Investigation criticises the proliferation of statutory duty and the risks of undermining the independence of the regulator and its ability to promote effective competition.

As noted in above examples, Energy UK believes that Ofgem is already empowered and willing to encourage innovation, either through tackling regulatory barriers or in supporting the testing of new offerings.

**If you would like to discuss the above or any other related matters, please contact me directly on 020 7747 2931 or at [steve.kirkwood@energy-uk.org.uk](mailto:steve.kirkwood@energy-uk.org.uk).**