



Which?, 2 Marylebone Road, London, NW1 4DF
Date: 21st January 2019
Response to: Samuel Railton, HM Treasury

Consultation Response

Encouraging innovation in regulated utilities

Dear Sam,

Many thanks for the opportunity to respond to this consultation.

Which? agrees with the importance of innovation as a critical driver of productivity and economic growth. In particular, Which? has identified innovation as a key driver of consumer benefits in the energy sector. This is reflected in innovation being explicitly identified among Which?'s 5 Key Tests to be used to judge the success of the price cap¹.

Which? recently commissioned and published a report on innovation in the energy sector - and how this might be impacted by the price cap - from Cornwall Insight². This response draws on that report to focus on insights about innovation in the energy sector, and we have supplemented this with further insights about innovation in the telecoms and water sector where we have them.

While not considered in detail through this consultation, we are also currently looking in-depth at the rail sector, where innovation in the passenger interest appears to be slower than other areas. The "B.A.R.R.I.E.R.S" report by HackPartners³ set out the main reasons for this, and DfT and the rail industry have taken on many of its recommendations. However, we think that the current limited nature of the regulator's powers in this sector undermines regulatory certainty and policy coordination in this area. The Rail Review should examine the impact on innovation of the current regulatory structure closely.

Summary

Overall, Ofgem has done a fair job in encouraging and facilitating innovation in the energy sector. However, given the pace of technological change in the sector and scale of future consumer benefits at stake, we cannot afford to be complacent. For example, the inconsistent pace of the smart meter rollout (along with associated technical difficulties and communication issues with consumers) has limited the extent to which the potential consumer benefits are being realised.

Based on our work with Cornwall Insight in energy, we have identified four key themes - minimising regulatory uncertainty, encouraging consumer engagement, a proactive regulatory

¹ Test 3: It must not stifle innovation <https://press.which.co.uk/whichstatements/which-responds-to-the-draft-bill-for-an-energy-price-cap/>

² Technological change and innovation in the GB energy market - how might it be impacted by the default tariff price cap? (Cornwall Insight, June 2018), available at: <https://www.which.co.uk/policy/utilities/2808/innovation-in-the-energy-market-impact-of-the-default-tariff-price-cap>

³ www.hackpartners.com/strategic-advisory



approach and policy co-ordination - that we think can help to drive innovation in a regulated industry, and these are set out in more detail below.

Responses to specific questions

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

In their report, Cornwall Insight collected views from a range of energy industry participants about the current barriers to innovation⁴. Specifically, the number and complexity of relevant legislation was cited as a problem, along with the unpredictable nature of the regulatory climate leading to increased commercial risks.

Based on the relatively high proportion of applicants to Ofgem's 'sandbox' whose proposals were already compliant with existing regulatory frameworks (further detail below), regulatory complexity seems to be a particular constraint for those looking to trial new and innovative approaches. In addition, a number of stakeholders commented about the high degree of recent regulatory and policy change in the energy sector, which was leading to uncertainty among investors and raising commercial risk.

Both of these points suggest that **minimising regulatory uncertainty** is an important outcome for regulators to achieve in helping to support innovation.

2. 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?

Consumers play a key role in helping to drive innovation, through demand-led pressures for new products and services. We see consumers as continuing to play that role in energy and other regulated sectors, so it is critically important that regulators continue to **encourage consumer engagement** in the market, in order to help support that. Ofgem also has an established Consumer Challenge Group⁵ and Consumer First Panel, as well as a wide-ranging consumer research programme, which helps it to understand the consumer perspective on current and future innovations.

In the energy sector, Ofgem has already made a number of positive steps towards supporting and facilitating innovation from a supplier perspective. Its Innovation Link and regulatory 'sandbox' (building on the FCA'S approach) offer suppliers the opportunity to discuss and submit proposals for new and innovative offerings, while licence derogations can be sought for specific changes. The support criteria for proposals considered through Innovation Link include demonstration that there should be "clear benefit for consumers", which helps to balance consumer protection and commercial incentives.

Energy network operators are also able to pursue innovative strategies through provisions in their licences and specific funding arrangements (Network Innovation Competition, Network

⁴ Supplementary annex at: <https://www.which.co.uk/policy/utilities/2808/innovation-in-the-energy-market-impact-of-the-default-tariff-price-cap>

⁵ <https://www.ofgem.gov.uk/network-regulation-riio-model/current-network-price-controls-riio-1/riio-1-forums-seminars-and-working-groups/consumer-challenge-group>

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