

'How do we get the shift that government, regulators and industry need to make to transition to a fair, smart and low carbon future energy market?'

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Consumers at the heart of the future energy system
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We've heard a lot this morning how we are in the midst of an energy transition.
Three disruptors are driving this:

- **Technological change** – big data / digitisation, block-chain, decentralised and renewable energy and AI/robotics etc which are impacting on businesses and consumers.
- **Climate and environmental change** – need to decarbonise and ensure system is resilient to more extreme and unpredictable weather – **and** consumers are able to better withstand these shocks.
- **Societal change** – increasing inequality (between different groups of consumers – incomes, ages etc - and also geographically between regions), the precariat, polarisation, desire for greater control / say and the 'democratising' impact of many new technologies.

My key point this afternoon is that when you think about how to get the shift that government, regulators and industry need to make to ensure the transition to a fair, smart and low carbon future energy market you **need to take account of and address all three drivers for change**.

This sounds obvious but is a **fundamental point that is frequently missed**. Extinction Rebellion want us to fix things now and bring net-zero targets forward from 2050 to 2025. Tech players are developing amazing new offerings – and understandably want to corner markets or grow market share. And last but not least consumers want low bills, to avoid price spikes and more tailored and responsive services.

Absent a **coherent approach**, which seeks to **balance these different challenges**, solutions and approaches are unlikely to 'stick.' And **trust** in the energy system may well be eroded further.

We are in uncertain territory here. Things are **dynamic and moving quickly**. Data is creating new feedback loops which can make it difficult to control and manage debates in the way we have approached these issues in the past.

Fresh thinking is urgently needed. We need to ask fundamental questions about what the **role of government, regulators and companies** is in the future energy system – if **consumers and citizens are going to do their part** going forward.

Because the **role of people** is crucial. Whether it is as consumers or citizens, individually or collectively, we all have a role to play. To: pay for the transition, reduce and adapt our usage and change our behaviours, where necessary become active participants in the market and to help each other out when we struggle to pay our bills or extreme weather brings the power down

We need a **strategic review of roles and responsibilities** that looks at the **cumulative impacts of these three drivers for change** and what this might add up to for us as people.

So as we go through transition, **who should do what?** This afternoon, I want to set out Sustainability First's **early thinking** on what key actors could do to get the shift to a fair and low carbon energy system. In doing so, I hope to explain that although I don't think we have the 'right' answer to this at the moment – and indeed there is unlikely to be one 'right' answer - **radical change certainly is needed**. And this radical change needs to recognise that in these febrile and volatile times, when everything is 'up in the air,' **you can't pigeon hole issues into neat silos or people into consumers and citizens.**

So what should government do?

We are expecting an energy white paper this summer. With or without this – and who knows what will happen with the wild card and limited bandwidth of Brexit – we consider that **policy and regulation needs an overhaul**.

Given the rapid and uncertain pace of change, **institutional innovation** is just as crucial as technological innovation.

Our existing **frameworks were built for an analogue world** where personalisation of services was only a gleam in policy makers eyes. Where **regulation was developed to act as the 'proxy consumer'**, serving the mythical '**average**' consumer and '**rational**' decision maker.

This was a **simpler, more centralised and top down world**. A world before social media, before enhanced consumer engagement mechanisms, before more muscular regional government, before metro mayors and before hybrid business models and new city and community-based approaches.

Our current policy and regulatory **frameworks were also constructed** when the impacts of **climate change** were less certain and not necessarily 'felt'. Before the **IPCC's** recent work which has given us the dire warning that 'nothing in human

history has yet been done at the **scale** of the necessary transition' and that the **speed of change needed** has only been seen once before in human history. That the 'time consistency' in our responses to this threat is crucial to make this 'manageable'.

Existing policy and regulatory structures were created before the **Committee on Climate Change** had pointed to the **gaps we face in meeting the fourth and fifth carbon budgets** – and that to bridge these will require not 'big power' changes but practical real world changes on the ground by billions of households. Households that may not have the money for a new heat pump and may baulk at the idea of having their gas boiler pulled out -particularly if they have just redecorated their kitchen.

And the existing policy and regulatory settlement was struck **before austerity** and **before universal credit**. When there was still an **expectation that the state would provide** and look after people who had additional needs or were down on their luck. At a time before the scales had tipped to the **private rented sector** where energy efficiency schemes and smart tech can struggle and cold, mouldy and expensive homes are a reality for many – including those in child poverty and young people who will never become home owners.

Against this backdrop, it is perhaps not surprising that 'tinkering at the edges' of policy and regulatory reform is not sufficient'. So what can government do? Here are seven suggestions:

1. Perhaps most important, government needs to identify where **it itself needs to act** – at the international, national and local levels. International activity on mechanisms such as carbon taxes is likely to be needed going forward. But national activity on standard setting (eg for zero carbon homes, tighter building regs, smart appliances, interoperability) will also be important. Crucially, renewed attention will also be needed for the cinderella of the energy sector - energy efficiency schemes/funding. Along with support for those without broadband access and skills so that they too can become smart consumers. And assistance for those with additional needs or in vulnerable situations.
2. Government needs to set the **strategic direction** for the energy system. **Strategic Policy Statements for regulators** are key here. These need to address several questions:
 - What public interest outcomes should the energy system deliver?
 - How should we balance good consumer outcomes with good citizen outcomes?
 - How should we prioritise these different outcomes? To do this, policy makers clearly need to develop a **view of the cumulative distributional impacts of**

change within and between generations. Without a joined up view of what these are likely to be, it can be difficult to say whether the energy transition is truly ‘fair’.

3. Develop a **vision for regulation for the Twenty First Century** – that needs to look beyond energy. As we have been discussing today, data is blurring the boundaries between sectors. This vision needs to set out how regulation needs to be restructured to ensure consumers and wider public interest issues sit at the heart of new arrangements.
4. Develop a **road-map for regulation to 2030**. This needs to align regulatory duties with government policy and advice – across departmental silos. For example, with the commitments that we have made for UK implementation of the **UN’s Sustainable Development Goals, the Industrial Strategy and the Clean Growth Strategy** – together with emerging advice from bodies such as the **Committee on Climate Change and the National Infrastructure Commission**.
5. Many options for radical structural regulatory reform have been put forward. These could include restructuring regulation to move to a **separate data or consumer regulator** or to **systems regulation**. However, Sustainability First considers that until some of the ‘big pieces’ of the jigsaw are sorted, such as data regulation, this could be premature.

We therefore think that developing a **publicly agreed set of criteria** to test different options for radical regulatory change is a vital first step. Greg Clark’s ‘four principles’ that he announced in his ‘end of the trilemma’ speech last year are a good start. However, these were focused on the **technical aspects of the power sector**. **People and communities were notably absent**. To really change what happens in people’s kitchens, living rooms and bathrooms, and as we go about our day to day lives, a **more people centred set of criteria** are needed.

6. We need to ensure government and regulators have **better data to underpin policy making and regulatory oversight in this new data-driven world**. Sustainability First’s Public Interest Advisory Group – PIAG – is exploring how smart meter data can be better used for the public good so that policy makers and regulators are not ‘flying blind’ into the future.
7. Last but not least, **public engagement** will be essential to navigate the choices that will need to be made as the transition unfolds. The full range of **deliberative engagement** approaches will be needed here. As much of this will be about **value judgements, trade-offs and balancing different interests**, it is crucial that this

isn't just left to companies. Policy makers and regulators have a role here through **citizens juries and assemblies**. Last year a citizen's assembly on the funding of social care was commissioned by two parliamentary select committees. Is it time that one was commissioned on paying for the energy transition, fairness and the principles for cost recovery in this new world?

Without government action in all of these 7 areas, it could be difficult to get the delivery of the **systems benefits and co-benefits** that consumers, citizens and communities rely on to **reduce costs for individuals and the wider energy system**. A disjointed approach may also make it more challenging to manage the **interdependencies** that need to be understood to provide **sustainable and resilient services** going forward.

None of this is a call for picking winners or being unduly prescriptive. It is about providing the **agile frameworks** that are needed to enable the low carbon transition.

Unless **government with its democratic mandate** does this, there is a significant risk that the energy transition is not seen as 'fair' and 'just.' If large chunks of society are '**left behind**' public backlash may follow. A lack of clarity on the **respective roles of government and Ofgem** on distributional impacts (where government sees 'technical' regulatory changes as being strictly for Ofgem and Ofgem sees redistributive actions such as social tariffs as being for government) is in no-one's interests.

What can Ofgem do?

What about the role of the regulator? Once **government has redrawn the regulatory framework**, there is still much that needs to be done to ensure that they are best placed to help make the transition to a fair, smart and low carbon energy system.

Ofgem needs to work **strategically on cross-sector issues**, in **collaboration with other regulatory bodies** to develop more joined up approaches to issues such as vulnerability and long-term resilience.

The **energy price cap** has in some ways brought some breathing time in terms of short-term fairness. However, **providing a bridge to a post price-cap smarter world is essential to get inter-generational fairness**. Ofgem is currently engaged in root-and-branch reform of **electricity network charges to help do this**. These charges will become more reflective of the costs of the system but **unwinding some historic cross-subsidies** and changing how fixed costs are allocated, will create winners and losers in the process.

They have recently consulted on the **Targeted Charging Review** and are reviewing **Access and Forward-Looking Charges** – and are considering the way forward on

market wide **half-hourly settlement**. A review of the retail market touching on the possibilities of **new business models, peer-to-peer trading etc** is also expected.

While it is **understandable** from Ofgem's point of view that they need **to carve up the work to make it manageable**, there still needs to be a strong sense of what this means for consumers overall. What matters to people is the cumulative impact of all these changes and whether the energy system that emerges is one that is seen as "fair" for all.

Sustainability First is generally **supportive of the direction of travel as being to provide more cost-reflective price-signals to market actors**. This in turn will **drive innovation and incentivise retailers to find a variety of ways to motivate their customers to play their part in keeping the overall energy system in balance**. We also recognise that a greater proportion of system costs will be fixed going forward.

To avoid the dual goals of de-carbonisation and maintaining affordability of energy not being jeopardised by the cumulative impact of detailed market reforms, we consider that it is vital that **Ofgem and BEIS work together to look at the full picture**, taking account of the **cumulative distributional impacts of the wide array of changes** I've set out and how these feed through into end-use tariffs. **These issues can't be left to a technical annex but need open debate.**

Radical, strategic thinking from a consumer perspective is also needed to consider some very **different models of how we pay for our energy going forwards**, which could include the following four ideas:

1. More reliance on **general taxation** or the use of **council tax bands** as a basis for charging.
2. Some sort of **universal service charge** with exemptions for certain groups of customers or for certain business models.
3. Having a **fixed charge creating an entitlement to an essential level of energy** at reduced rates.
4. Stick with the **current usage-based charging but introduce a separate fixed charge for customers who want to export onto the system**, directly targeting the "free rider" problem that is exercising policy makers currently.

And while the early debate has focussed on the structure of network charges there needs to be a parallel debate on what these fundamental underlying changes may ultimately mean for **retail prices**. **Should suppliers continue to be free to pick their own tariff structure?** Or should elements of that structure become **mandated**? Could that help as a step towards a price-cap free world?

These are big questions that go well beyond the remit of an economic regulator. It clearly **makes sense that Ofgem and BEIS are working together on the retail market**

review and the proposed Energy White Paper provides another opportunity for government to provide some strategic direction. Sustainability First will be examining these matters in more depth later this spring in a forthcoming discussion paper.

Last but not least, what can industry do?

Innovation is desperately needed in the energy market to address **each of the three challenges** outlined at the start of this speech. There is increasing recognition that this needs to cover not just new gizmos and technologies but also new processes, systems and business models.

Working with consumers, citizens and communities – **co-creating, trialling and testing** – is clearly important here. Indeed, **early adopters** are crucial for trialling new technologies to tackle some of these challenges.

But we also need to recognise that **for some consumers, trialling new methods and approaches may not be an option**. Without access to **funds, support and enabling infrastructure** – which may sit outside of the energy sector (eg broadband, EVs etc) - some people and communities run the real risk of being left behind. Energy companies need to recognise this and develop **partnerships and collaborations** with others to help address this issue.

Companies will increasingly need to work in a **cross-sector** way on many social and environmental issues. For social issues, this will involve giving more weight to **joined up people centred solutions** such as '**tell us once**' / '**one stop**' services that recognise the **dynamic nature of vulnerability** and that **people do not live their lives in sectoral silos**. For environmental issues, this is likely to reflect the fact that 'whole systems' and 'cross systems' solutions may be increasingly important as the value of more **circular and integrated approaches** increases.

On the social side, Sustainability First's work has shown that all too often, innovation to support those with **additional needs or in vulnerable situations** has been more prevalent in energy networks than amongst energy retailers. This is frequently as a direct result of regulatory incentives in RIIO. **Ofgem's new vulnerability strategy** will need to address this issue for retailers.

In the meantime, many energy companies and new entrants are asking themselves what it means to '**play in this space**' in terms of their **social and environmental obligations**. Our '**Fair for the Future**' project, is exploring changing expectations on companies – and indeed the wider sector - around fairness, from a socio-political, environmental and economic standpoint.

Our strawman '**Sustainable Licence to Operate**' for the energy and water sectors has proposed a 'typology' of fairness which we are now testing with key stakeholders. Part of our hypothesis is that as fairness frequently involves **balancing different**

interests, and questions of **value judgement**, it is essential that there is a **step change in how stakeholders are engaged in deliberations as to what is fair** – in a way that is meaningful to them – by **companies as well as government /regulators**.

This needs to **extend beyond seeing ‘engagement’ as being just about switching activity** or basic market research to how companies listen and **involve** their customers in the difficult decisions they make. This could range from **customer panels, through to enhanced engagement to have consumer and future consumer reps on boards**. Absent this, Andrew Tyrie’s comments about the public doubting whether markets work for their benefit may ring true.

To address this, companies need to look deeply at what their **purpose** is and how this is reflected in their **corporate governance, values and behaviours**. Post 2008, post Carillion, questions about what it means to be a **‘purpose led’ and responsible business** are growing across the economy. Discussions around Section 172 of the Companies Act are very live. Companies that operate in the energy space are – whether they like it or not – very much in the front line of these debates.

Sustainability First’s Fair for the Future work on developing a **‘Sustainable Licence to Operate’** was partly kicked off to see how far companies could go by taking a more **proactive and agile approach** in these areas. To encourage what some have called the **‘forward compliance’ to regulatory change** that is going to be needed in a fast-moving world. We hope that by identifying what companies can do on their own, it will help **highlight how far you can get with principles based and ethical regulation** and where **government and regulatory intervention may still be needed**.

To conclude

In this speech I’ve outlined that to address the challenges that we face, we need to see **action by government, regulators and companies**. The challenges faced are of a scale and complexity that **action by one group of actors alone will not be enough**. The trade-offs between them require a **co-ordinated and iterative response**.

Lastly, this may all **sound bleak**. To get the changes needed requires a **positive framing** – rather than one just focused on reducing harm. We need a **compelling and coherent narrative for change** which sets out how we will **share the opportunities of the transition – as well as the risks it brings** - in a wide and inclusive way. We need to **take people with us - not ‘do’ change to people**.

An Extinction Rebellion banner last week read **‘The greatest threat to our planet is the belief that someone else will save it.’** The steps I’ve outlined today require everyone at this conference to act - if we are to build trust in the energy system for the future.