Industry & Regulators Committee inquiry into UK regulators
Sustainability First **response to call for written evidence**

Inquiry webpage: UK Regulators - Committees - UK Parliament

Call for evidence page: Call for Evidence - Committees - UK Parliament

Deadline **1st December 2023.**

Contact: HLIndustryRegulators@parliament.uk

"For this inquiry, the Committee is focusing specifically on regulators which a) **have a statutory role established by Parliament and b) are organised as public bodies**."

This response from Dr Martin Hurst of behalf of Sustainability First reflects our long and wide experience with utility, consumer, housing and environmental regulators. Our associates include former directors in Ofwat and Ofgem; the regulation and arms-length body director for Defra and the (civil service) No 10 environment, farming, housing and planning advisor. We have served on the Ofgem RIIO challenge group throughout its existence, and on Ofwat advisory groups. Our members have chaired customer and environment panels across energy and water.

We are a politically neutral charity and thinktank that specialises in the water and energy sectors.

We do not cover all 90 regulators of interest to the committee. Our response focuses on:

- The three 'economic' utility regulators: Ofwat, Ofgem and Ofcom, plus the CMA
- The main environmental regulators: Environment Agency, Natural England, MMO, JNCC
- The housing regulator
- Housing and wider ombudsmen (to the extent that they can be termed regulators)
- Consumer regulators
- The Information Commissioner

We have published a number of studies relevant to this enquiry including:

- Public value in utilities: implications for policy and regulation
- UK public interest group on access to smart meter data
- Recent work on the issues surrounding sewage discharges and regulation
- Work identifying failings with regulation of economy 7 and similar tariffs
- Numerous studies on how to involve customers through regulation and helping regulators reach and understand hard to reach groups

The Committee has said it is interested in answers to the following questions:

1) Are UK regulators being given a clear job to do?

We do not think that wholescale changes to the legislation setting down regulator objectives is needed. Our work with Slaughter and May found that in many cases the issue was not about regulatory powers, but political cover. There may, however, be a case for new duties on net zero etc, in order to demonstrate this cover.

That said, we welcome the extension of powers and duties to the housing regulator to enhance its ability to ensure tenants are better protected and their voice is properly heard. And we have identified a systematic short-term bias in many areas of regulation. We have repeatedly underlined the need for an institutional voice for the long-term in utility and environmental regulation.

There is also an urgent need for re-examination of regulatory frameworks and capabilities in the face of machine learning/AI; our work has found that such frameworks typically and systematically lag behind technological change. This is true not just of regulation of the technologies themselves (e.g. recent discussion about regulation of AI), but also regulation of firms which may adapt their operational model to incorporate machine learning/digital twins. An example would be management of utility systems.

The same lag appears to us to be evident regarding adaptation to climate change. Firstly, environmental regulators in particular are charged with ensuring protection and enhancement of existing habitats and species, rather than ensuring we move to resilient habitats, and in some cases manage abandonment/transition of those which cannot cope with increased heat, sea level rise or drought. Secondly, land use regulation and regulators have comprehensively failed to address the issue of living with increased urban heat. In both cases we need action from government, but we also need greater use of existing flexibility from regulators.

There has been systematic underfunding of certain regulatory duties: for example, the Environment Agency's ability to regulate and monitor discharges to water. As a result, enforcement has been downscaled. We very much doubt that the EA's decision to step back from enforcement of low category water pollution incidents (even if on occasion these involve 6 inches of raw sewage in a childrens' play area) would reflect societal demands.

2) Is the right balance being struck between the responsibilities of regulators and those of the government, particularly where there are political or distributional trade-offs that need to be resolved?

In short, no. We have argued for example that government's strategic policy statement to Ofgem, while containing much that is welcome, failed to address the issue of how trade-offs should be decided. The strategic policy statement to Ofgem is in our judgement if anything worse.

The government have also ducked the strategic issue of the balance between the roles of the welfare state and help for poorer customers through regulatory approaches. For example, take up of help for customers in financially vulnerable

situations regarding water is very low – and the approach seems to owe more to a desire not to tackle the issue through welfare spending than an analysis of the optimal strategic approach. This was also evident in energy discussions about the price cap and recent one-off support with energy bills.

3) Are regulators appropriately independent of government? Is the right balance being struck between strategic and political input from government and preserving the operational independence of the regulators?

Francis Maude's '3 tests' for the continuation of arms-length bodies over a decade ago accepted the case for regulation to remain independent of government. We concur. In some cases, this is reinforced by the quasi-judicial role given to secretaries of state in ruling on appeals against regulatory judgements.

However, in practice, we have seen over the past decade a number of regulators, most notably in the environmental space, becoming increasing constrained in their ability to be and be seen to be independent. This is due to political judgement and pressure including through appointing regulatory boards which are unlikely to kick over the traces – Tony Juniper's appointment as Natural England chair is a welcome and notable exception here. It is also due to the impact of bringing many core support functions into the centre. So, for example, the Environment Agency, with expertise on floods and a key regulatory role, has been forced to use the Defra communications team for its external communications.

One impact of this is that we see a number of regulators becoming very risk averse: for example in requiring large expenditure on concrete (and carbon intensive) solutions to improve water quality and reduce water company discharges, rather than allowing cheaper and more widely beneficial – but less certain – nature-based solutions.

4) Does the government provide too much or too little guidance to regulators in making decisions, particularly in deciding between different objectives and priorities?

We are strong advocates of clear and transparent strategic guidance from government, in particular in terms of prioritisation and trade-offs. This was a particular issue with the Defra strategic policy statement to Ofwat and even more so in the draft DESNZ strategic policy statement to Ofgem, but it has also been an issue with recent apparently ad hoc and opaque steers to the Environment Agency.

5) Are the roles and remits of different regulators sufficiently discrete, or is there overlap and duplication?

A degree of overlap or gaps between regulators is probably inevitable.

In some cases, this has however led to very significant problems. In the water sector, there has been an evident failure to plan for environmental investment for the longer-term, or to find best value solutions where planning does happen, such as in the flawed WINEP and WRMP processes, or to properly ensure delivery by the water companies. One of the root causes of this failure is the lack of a clear

regulatory approach, with the Environment Agency nominally responsible but lacking the tools or capabilities to deliver which are more a function of economic regulation (and hence would better sit with Ofwat). The split of responsibilities makes it more difficult to drive needed changes, to bring the water sector back on track with society's expectations.

Another problem can be the extent of devolution to local teams within some regulators whereby there can be an excessive inconsistency of message and approach. An example of this might be Natural England.

6) How effectively do regulators co-operate with one another, and how could this be improved?

We have seen and reported on a fairly widespread reluctance to work between (or even on occasion within) regulators – although co-operation between the Environment Agency and Natural England has improved. We have argued on a number of occasions for example that the UK Regulators Network is insufficiently ambitious in considering common issues such as the cost of capital and customer engagement. There may be a case for mandatory co-operation on such vital common issues. Too often the regulators see coordination through bodies such as UKRN as something they are required to do rather than a source of value and are inherently defensive and protective. This can be seen in the UKRN cost of capital approach which predominantly adopts a least common denominator approach and enables the individual regulators to continue their own bespoke approaches rather than genuinely converging.

We also see case after case where regulator approaches have failed to understand the 'principal agent problem' and have instead created incentives to 'game' the regulator and to create and excessive 'parent child' relationship. We believe more should be done to explore ethical regulation across regulators, and approaches such as negotiated settlements through which the regulator stands back and encourages a greater role for suitably informed third parties.

7) Do the UK's regulators have the necessary skills, capabilities and expertise internally to perform the roles they have been given? If they do not, how could this be improved?

Inevitably regulators tend to be more focused in gathering regulatory skills, than in skills which understand customers or business models of those they regulate. However, the jobs market is very tight, and now may not be the easiest time to address this. Furthermore, regulator budgets are often tightly controlled – so for example the Environment Agency's budget on water regulation has declined markedly, which leads to an inevitable prioritisation of 'must have' skills rather than the 'nice to have' skills.

One impact of this however is that many regulators have insufficient diversity of thought among their senior leadership teams.

This is also true – and is easier to tackle – with regard to skills etc on regulatory boards: for example, neither the Ofwat nor the Ofgem board contain Non Executive Directors with a strong environmental background.

8) Who should hold the regulators accountable for their performance against their objectives? What is the appropriate role of Parliament in performing this scrutiny role?

There are of course institutional checks on regulators, such as the NAO and in some cases the CMA. The role of the NAO could be expanded. But we would argue that the adversarial approach of the NAO (and Public Accounts Committee) can enhance an already excessive degree of risk aversion in regulators.

We believe that regulator boards should have a key role here as well, but too often the boards do not do this and we have observed on occasion a reluctance to appoint individuals to boards who might take this role.

Ultimately many regulators suffer from a democratic deficit. We would support greater involvement of local authorities in holding regulators to account, perhaps through a model similar to the regional flood and coastal committees.

There is obviously a role for Parliament here too. The Environmental Audit committee seems to us a fairly good role model. As mentioned however, scrutiny needs to be balanced, and not exacerbate risk aversion and a culture which is worried about regulatory innovation.

9) How should the government and the regulators themselves facilitate appropriate scrutiny and accountability of regulators? Are regulators sufficiently transparent about their own performance?

We doubt that the creation of an 'Ofreg' to scrutinise the regulators would be worthwhile. We do think that regulators could do a lot more to improve transparency, and to create more formal user groups and end customer groups to input to their thinking – and be seen to respond to the points these groups make.

Few of the regulators we work with have systematic relationships with local authorities or elected mayors, at anything other than at an area level.

The government should also be more willing to appoint stronger members of regulatory boards.

10) What mechanisms and metrics could be used to hold regulators accountable on a regular and ongoing basis and to judge whether a regulator is performing well?

This is very far from an exact science, and we suspect that the appropriate metrics for, say, Ofsted might be very different from those for the Marine and Maritime Organisation. There is also a big difference between regulation of consumers and companies.

Regulators already produce a significant volume of reporting on their activities, with annual reports typically supplemented by various reports to government on particular issues. It is often unclear whether these reports add any real value, or are

even read by those who might be interested. This adds to the extent that regulatory communications privilege companies with large regulatory teams who can keep on top of the deluge of publications and disadvantage potential entrants, environmental stakeholders and those representing the interests of consumers.

Genuine transparency comes not from publishing reams of information, but from information being both accessible and useful, and hence used. We would therefore suggest that alongside any proposals to add additional reporting requirements, past reporting could be rationalised to help the most useful information stand out rather than being buried.

That said, the question is a very good one, and has been insufficiently studied – perhaps we should ask how a regulatory 360 degree appraisal might work?

11) Do any of the UK's international comparators address the above questions particularly well? What lessons, if any, can the UK learn from other jurisdictions on these matters?

We have little to offer here.