Global Infrastructure Investor Association
Promoting Private Investment in Infrastructure

REGULATING FOR INVESTMENT

G L O B A L I N F R A S T R U C T U R E I N V E S T O R A S S O C I A T I O N

FOREWORD

Saying we are 'at a critical juncture' is a tired cliché when you are trying to attract attention for your cause. But there is no better way to describe the situation in the UK infrastructure sector currently. The Government, rightly, has high ambitions for infrastructure in the UK. The net-zero vision of the UK with affordable, high-quality and resilient infrastructure capable of meeting society's expectations in the 21st century is one we all share. But we will not get there without a programme of urgent policy and regulatory reform.

Our members have a relationship with the UK market that goes back decades, and are committed long-term investors in a wide range of UK infrastructure assets. For many of our international members, the UK was their first foray outside their home markets. The UK was a pioneer in attracting swathes of private capital to improve the upkeep and efficiency of important public service infrastructure assets. The country's relatively stable and predictable policy and regulatory regime has been one of its greatest attractions. However, as set out in our previous report, The Future of Regulation, the regime has struggled in recent years to deliver what the UK needs. Although the Government has set out an agenda for the reforms it believes are needed to the framework of economic regulation, these are unlikely to go far or fast enough.

Meeting the societal and climate challenges of the 21st century, alongside growing consumer expectations on service quality, will require significant investment. This report provides a set of proposals for an overhaul of the policy and regulatory framework to incentivise this investment in a way that is efficient and affordable over the long-term. It is informed by discussions we have had with a range of stakeholders, including consumer groups and think-tanks. We want to kick-start an important conversation about what infrastructure we need, how we should organise its delivery and how it should be paid for in a way that is fair and affordable both within and across generations. These important questions have been ducked for too long, in the hope that an easier answer will emerge. We cannot afford to do so any longer, delaying will simply add cost.

It is essential for us to have an open and honest conversation about how conflicting policy goals should be balanced. Clearly communicating this to the public in a way that generates enduring consensus is the shared responsibility of Government, regulators, companies and civil society groups. We must rise to the challenge.

Lawrence Slade
Chief Executive Officer
GIIA

REGULATING FOR INVESTMENT

The Global Infrastructure Investor Association brings together many of the world's leading institutional investors, including fund managers, pension funds, insurance companies and sovereign wealth funds. Our members deploy capital in infrastructure assets throughout the world and have over $250bn of additional capital ready to invest.

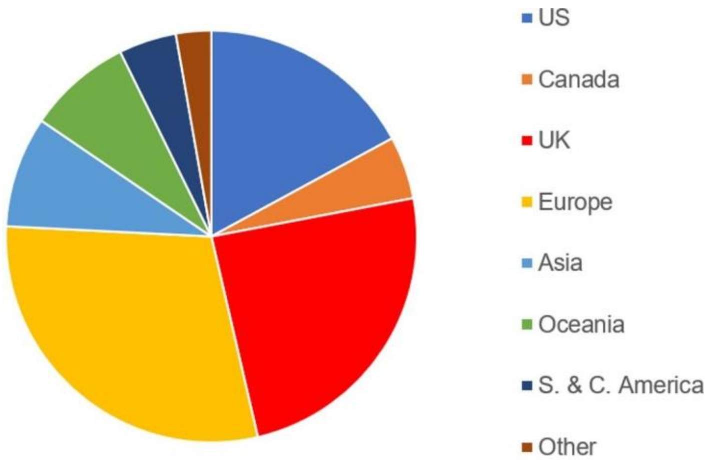
The UK has been one of the world's leading destinations for international infrastructure investment. Privatisation started the process and the UK's strong legal tradition and innovative policy and regulatory environment sustained it. Today, our members have £130 bn in infrastructure assets under management in the UK.

Despite this impressive historic track record, if the UK is to deliver on its Net Zero commitments and provide the resilient infrastructure that communities need, it will need a step change in the level of infrastructure investment. Our members are ready to rise to this challenge, but to do so they need an urgent programme of policy and regulatory reform.

If the Government and regulatory agencies can deliver the necessary change, we can together unlock the affordable, high quality and resilient infrastructure that will contribute to economic growth and thriving communities and businesses. We can ensure that homes and companies have access to secure and reliable energy supplies, clean water and high speed communications. We can deliver transport networks that enable rapid and efficient movement of goods and people. These critical services need to be resilient to both physical and economic shocks – the risks of flooding, of scarcity and of disruption should be minimised as far as possible. We all share a concern for the environment and nature and their preservation is crucial to the prosperity of future generations.

The significant pipeline of investment that the Government has committed to will need to be paid for – either by the taxpayer or the consumer – in a way that is mindful of the pressures on affordability. In the face of a cost of living crisis, strong in-built protections for vulnerable consumers are essential. But we also need to ensure costs are borne fairly across generations.

The UK's framework of regulation, in place since privatisation, has been highly successful in achieving its objectives. As we have outlined previously, it has delivered significant benefits and has been replicated the world over. However, in recent years, set against new challenges and expectations, it has been found wanting. The Government has recently recognised some of the issues with the current design of the regulatory framework, but we need urgent and decisive action to address long-running challenges.



GIIA's members invest in 2000 assets across 70 countries, with a cumulative total of $1.3 trillion of assets under management.

The absence of a Government-led long-term plan for the utility sectors has created a vacuum for regulators. They have often had to act without the necessary strategic direction and democratic mandate to make difficult choices. Inevitably given this context, they have tended to favour controlling short-term bills at the expense of long-term investment. A no-regrets approach to investment means regulators have been unwilling to allow the necessary level and speed of investment to secure the resilience of our infrastructure for future generations.

We need to address this now. Fixing the policy and regulatory frameworks to ensure they achieve their core objective and retain enduring democratic legitimacy through intergenerational fairness is the collective responsibility of government, regulators, operators and investors.

If we get this right, companies and investors will be able to spend less time worrying about how to manage and mitigate regulatory and policy risk and focus even more time on the innovation, commercial and operational decisions that matter most for consumers and society.

The UK has a chance once again to develop an innovative, world-leading model of regulation fit for today's challenges. This model should incentivise widespread innovative and efficient long-term infrastructure investment.

Achieving Consensus

Around the world, countries are asking the same question; how do we deliver the affordable, high quality, resilient infrastructure we need? This question raises challenges that governments, regulators, operators and investors should be jointly working together on to solve. In producing this report, we have tried to provide a constructive contribution to some key challenges that all parties need to jointly develop solutions to address:

- How do we get better alignment between government policy objectives, regulatory priorities and future investment plans?
- How do we build more consensus within society about the challenges we face in terms of our infrastructure needs and the costs of delivering them?
- How do we best incentivise the transformational levels of investment needed to deliver Net Zero, Climate Adaptation and Levelling up agendas whilst ensuring value for money for consumers?
- How do we ensure the costs of new/improved long term infrastructure are spread fairly and equitably across current and future bill payers?
- What standard of resilience do we want our infrastructure to be held to in the future?
- How do we facilitate and encourage new and innovative delivery mechanisms (such as more more nature based solutions) that may be cheaper and more effective in the long run, but are less precise and predictable in terms of performance and may take longer to deliver?

Any reform of the policy and regulatory framework needs widespread support from all stakeholders. In preparing this report, we have engaged with a range of important stakeholders, including consumer bodies, politicians and think tanks **[1]**, to develop a blueprint for reform that we believe should gain widespread acceptance.

[1] Including Which?, the Institute for Government and John Penrose MP. See Annex 2

Our conversations have revealed a number of consistent themes:

- **The system of independent regulation broadly works, and should be preserved.** But some changes are needed to make the system more agile, flexible and accountable, so that it reflects changing circumstances and reduces political and regulatory risk.

- **Consumers and citizens value high quality infrastructure.** However, policymakers play a critical role in determining what investment is needed, when, and how it is delivered. Most users of infrastructure do not have the ability or desire to engage with these complex questions, beyond the essential requirements that the system of independent regulation delivers value for money and can be trusted to safeguard their interests.

- **Affordability is a major concern, and no programme of regulatory and policy reform can duck the issue.** However, there is low tolerance for public utilities not delivering – high quality is equally important.

- **There is broad agreement that long-term thinking is crucial to the longevity and health of infrastructure.** But today's citizens and consumers are rarely engaged in concepts such as intergenerational fairness. This is where policymakers need to step in and take decisions on behalf of society, directing regulators as necessary.

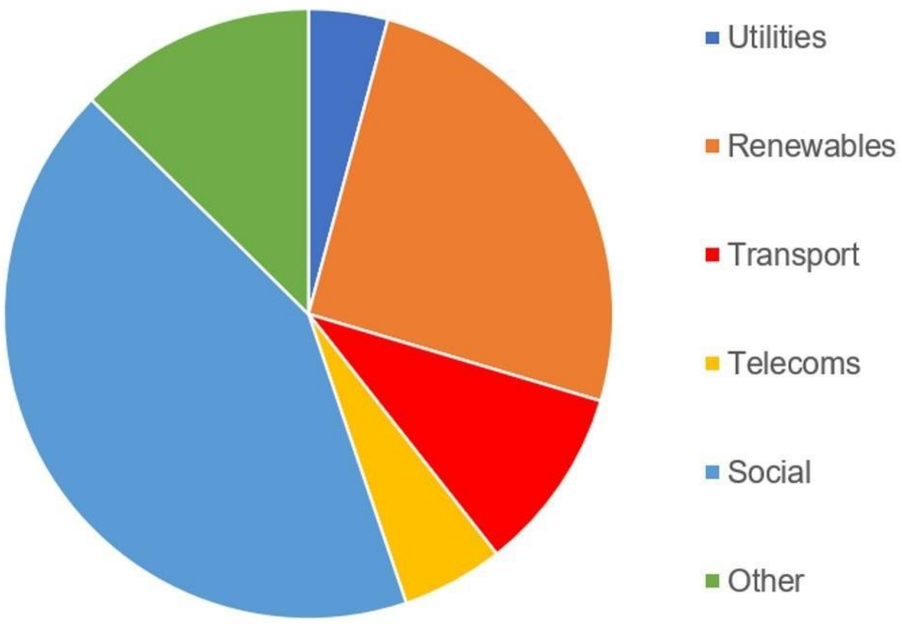
- **The regulatory regime should be simplified.** The role of competition should be expanded to allow the market to deliver efficient and innovative outcomes wherever possible. For assets subject to ongoing regulation, the framework should be less prescriptive, maintaining a focus on outcomes that consumers and citizens want. Regulators should focus on enabling and incentivising efficient delivery rather than attempting to control the specific financial and operational decisions of companies.

We welcome the Government's recent policy publications that have kick-started the debate. As the largest institutional infrastructure investors, we look forward to engaging with this valuable work and helping develop tangible solutions. This paper proposes an initial set of ideas for how the core objective – the efficient delivery of affordable, high quality, resilient infrastructure – can be achieved.

- Our proposals build on our previous report and advance specific recommendations, informed by our engagement with stakeholder groups. If implemented, they have the potential to renew the confidence of the investor community in the UK's world-leading policy and regulatory regime, kick-starting a wave of investment to enable the Government to deliver its objectives for growth and prosperity across the UK.

We set out our recommendations in three broad areas:

- Getting the institutional arrangements right
- Regulating to incentivise efficient delivery of high quality infrastructure
- Addressing the affordability challenge



In the UK, GIIA members have 500 investments covering all the main infrastructure sectors

1) Reforming institutional structures to ensure they are driving towards shared outcomes

Since the early 1990s, the UK's approach to meeting its policy goals for the provision of public utilities has centred on a system of economic regulation with independent regulators accountable to Parliament. This approach has delivered significant benefits and has been replicated the world over. It should be maintained.

However, the framework needs to be reviewed to ensure a clear delineation of roles and responsibilities between Parliament, the Government and independent regulators, accompanied by robust mechanisms to ensure accountability. Specifically, we need:

A long-term infrastructure plan to set strategic direction

- The Government – assisted by the National Infrastructure Commission – should lead a review, alongside other stakeholders, to define a shared vision for desired long-term outcomes in each sector.
- This should bring together other work already in train across Government (eg the Energy Security Strategy, implementation of the National Infrastructure Strategy).
- With the direction clear, regulators and other agencies can set the incentives to enable companies and investors to deliver the transformational change needed in each sector.

A streamlined set of statutory objectives to focus regulatory action

- The current set of regulatory duties should be aligned across sectors and simplified where possible.
- In principle, all regulators should have a core duty to focus on delivering the relevant outcomes for their sectors, linked to the long- term infrastructure plan.
- To ensure there is a focus on the long-term needs of society, duties should require regulators to promote the long-term interests of consumers and citizens.

Using Strategic Policy Statements (SPSs) to drive robust decision-making

- Government must ensure all regulators have an SPS. This is currently not the case for some regulators (e.g. Ofgem).
- Sectoral SPSs should clearly indicate how regulators should balance their statutory objectives and priorities to deliver the long-term outcomes in each sector, alongside shorter-term government priorities.
- The current frequency of refresh (once a Parliament) should be maintained to ensure agility, but there should be a clear link from one SPS to the next to provide consistency.
- The Government should issue a cross-sectoral SPS to drive consistency on a range of shared challenges (such as cost of capital assessments and consumer vulnerability). While the recent Open Letter to some regulators is a good start, a clear, overarching document that has an equivalent status to the sectoral SPSs will help provide regulators, investors and operators with certainty.
- The Government should explore whether the remit and responsibilities of UKRN should be upgraded, with the body put on a statutory footing with the necessary resources to drive consistency across sectors.

Robust accountability mechanisms to maintain democratic legitimacy

- The Government should maintain its commitment to a merits-based legal appeals regime in each utility sector and explore room for further consistency in checks and balances on the use of regulatory discretion and judgement to drive certainty and predictability.
- Regulators should adopt measurable targets and be subject to regular requirements to report against these to bring more political and democratic accountability. The FCA's Strategic Plan is a good recent example.
- Parliament should take a more active role in overseeing the work of the regulators. Relevant committees in both Houses should have the remits and resources necessary to scrutinise the work of the regulators against their refreshed duties and SPSs. The committees should hold regular evidence sessions and set out well-defined reporting requirements for the regulators.

2) Ensuring the regulatory framework incentivises the efficient delivery of high-quality infrastructure

Building sectoral frameworks to enable long-term infrastructure plans

- Investors and companies need to have the certainty and predictability to invest over the long-term. The guiding principle at the heart of each regulatory regime should be that companies have a reasonable expectation of recovering efficiently incurred costs (including a return on capital), regardless of the delivery mechanism used.
- Regulators and companies should continue to gather evidence on consumer preferences for infrastructure but should recognise the limits of this type of evidence and the need to take into account broader citizen interests.
- Regulators should design frameworks aligned to the long-term infrastructure plan for each sector. This means shifting the balance away from short-term bills and towards increased investment. In particular, regulators should permit anticipatory investment if it is in the consumer and citizen interest.

Expanding the role of the market to drive efficiency and innovation

- Competition should be embraced wherever possible to drive superior outcomes for consumers and citizens. In the regulated utilities sectors, this is likely to be competition for the market rather than competition in the market. While a set of common principles should guide the design of the competition frameworks, the frontier of the competitive market and the way it is implemented should reflect the different characteristics of each regulated sector.
- The Government should nominate an appropriate body to run awards, rooted in sector- specific circumstances (e.g. the Future System Operator may be best placed in energy networks, but there is no equivalent in the water sector).
- The Government (or commissioning body) should also form a view on the right allocation of risk in each sectoral competition framework, so that risk is borne by the parties best able to manage it. In practice, this will mean the Government taking on some tail risk that is beyond the control of investors and companies.
- Wherever possible, competition award frameworks should be technologically neutral and focused on clear, measurable outcomes (particularly on service performance, quality and resilience) allowing bidders scope to innovate. They should be open to new entrants and incumbents, subject to appropriate controls on conflicts of interest and operational and financial resilience.
- Frameworks should be designed to provide certainty over the long-term, ideally avoiding regulatory re-openers except in limited and well-defined circumstances. To the extent possible, bidders for new assets should simply bid their required revenue stream over the lifetime of the asset, with that revenue stream remaining fixed in the event that the bidder meets the agreed outcomes.

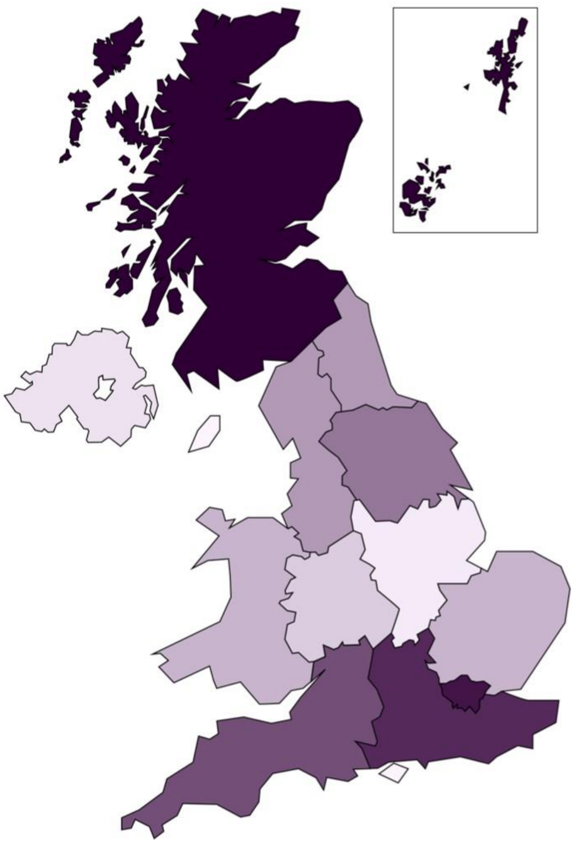
Ensuring the delivery of equivalent outcomes for assets not subject to competition

- Many assets will be subject to ongoing regulation, but this should be simplified wherever possible. Regulators should roll back existing prescriptive regulation (eg on financial structures) unless it is strictly necessary to protect consumers or drive efficiency. In some sub-sectors (eg. retail energy) intervention on financial structures may be the only way to protect consumers. In others (such as asset-heavy network businesses) there is more scope for regulators to focus on consumer outcomes and rediscover a bias against intervention.
- Any regulation retained in the rulebook or added over time should be subject to a robust cost-benefit analysis assessment, conducted with reference to the consumer and citizen interest.

- Regulators should design price controls with the overall aim of enabling the delivery of long-term outcomes set out in the sectoral infrastructure plans. This means an openness to innovative approaches such as partnerships and nature-based solutions that may only deliver results in the medium-to-long term.
- Regulators should design price controls (outcomes, performance commitments, incentives) flexibly in a way that spans multiple review periods, if it is clearly in the consumer interest. But there should be a commitment to simplicity over prescription, and a predictable approach to risk allocation between companies and consumers.
- Government should build on its existing plans (via the UKRN WACC Taskforce) to drive a consistent methodology to the elements of the cost of capital – shared across sectors, where possible. The methodology should only be updated at each price control review if absolutely necessary.
- Regulated companies should set out detailed long-term delivery plans that will enable them to deliver the target outcomes, including through the use of innovative delivery mechanisms (such as nature-based solutions). Regulators should assess company plans across multiple price review periods and set commitments and allowances accordingly.

GIIA UK Asset Statistics

Region	Assets
Scotland	76
London	72
South East England	48
South West England	32
Yorshire and the Humber	30
North East England	26
North West England	26
Wales	22
East of England	22
West Midlands	18
Northern Ireland	15
East Midlands	10
Isle of Man	1
Isle of Wight	1



GIIA members are contributing to the Levelling Up agenda through their investments across the UK

3) Driving affordability to ensure the system delivers for all parts of society over time

- Identifying groups that need targeted assistance and getting it to them
- Regulators and companies have taken huge strides in recent years to ensure that there is support available for vulnerable customers. But more can be done to enable companies to identify vulnerable customers that may potentially be in need of assistance, and mitigate serious harm before it may arise.
- Government should make use of its post-Brexit regulatory flexibility to review the barriers to data sharing and pooling with the aim of building a cross-sectoral database of customers in vulnerable situations. This would enable companies to target support accurately to customers when they need it.
- Government should direct the regulators to work together with the ICO, and challenge them to develop innovative regulatory tools to build in mitigants against any data-protection concerns.

Equitably distributing costs of increased investment within generations

- The cost of living and energy crises emphasise the need to ensure that investment programmes are funded in a way that spreads costs fairly. Building on the ongoing work under the cost of net zero review, the Government should clearly set out its expectations for how the cost of investment will be funded in each sector – between taxpayers and different groups of consumers.
- The Government should develop guidance for regulators to enable them to use their discretion and judgement in line with this expectation.
- Regulators should then enable (or where necessary require) companies to develop targeted tariff frameworks (e.g. social tariffs or differential usage rates) in line with the overall balance in each sector set out by the Government.

Building intergenerational fairness into the regulatory framework

- As part of adopting a long-term horizon for decision making, regulators should take a permissive stance towards investment – including anticipatory investment. They should recognise that the risks of inaction are now substantial and outweigh the relatively small risks of asset stranding.
- The Government should direct the regulators to review whether the current operation of the regulatory asset base model (including depreciation and capitalisation rates for different assets) in each sector continues to be the best way to determine the prices of many assets over time – and whether there remains a clear link between what consumers pay and the assets they are using.

ANNEX 1: BLUEPRINT FOR REFORM

Reforming institutional structures to ensure they are driving towards shared outcomes

A long-term infrastructure plan to set strategic direction

- The Government should define a long-term vision for desired outcomes in each utility sector, stretching out to 2050. A common goal will help drive action by policymakers and regulators to enable delivery by operators and investors.

- The Government should commission a review (co-ordinated by the National Infrastructure Commission) that brings together the views of all relevant stakeholders (including consumer groups, operators, civil society members and investors) to ensure that this long-term infrastructure plan represents a set of shared outcomes from across society. The review should build on and update existing initiatives and publications, such as the National Infrastructure Assessment (and Strategy), the Energy White Paper, Energy Security Strategy and Future Telecoms Infrastructure Review.

- The NIC should be given a central role to monitor progress, and to update the long-term infrastructure plan in response to changing circumstances. The Government should also consider whether the NIC's remit needs to be upgraded or enhanced, and whether it should be put on a statutory footing.

A streamlined set of statutory objectives to focus regulatory action

- We agree with the Government's view that regulatory duties should be clear, consistent and relevant to ensure regulators can enable the necessary strategic investment needed in the coming decades.

- In its upcoming review of the statutory duties of the utility regulators, the Government should ensure that the regulators have a clear and coherent set of duties to guide their decision making.
    - Each regulator should have a primary duty to further the interests of consumers and citizens in their respective sectors. A clear direction from Parliament that regulators should look after citizen interests will help regulators appropriately take account of the needs of future consumers, as well as society at large. Such an approach has for example enabled Ofcom to regulate the broadcasting sector in the interests of society as well as viewers; in water and energy it would enable Ofwat and Ofgem to take better account of wider environmental concerns relating to pollution and net zero.
    - Where possible, there should be consistency across sectors to ensure a unified approach to common challenges. But there should be a link to the outcomes in the long-term infrastructure plan for each sector. This may mean, for example, regulators are given specific duties in relation to net zero, environmental protection and resilience.
    - All other existing statutory duties should be reviewed to ensure they are focussed and essential to enable the delivery of the UK's overall infrastructure objectives. In some cases, Government may decide that duties that have built up over the years in statute would reside better in Strategic Policy Statements that can be amended more flexibly and frequently.

Using Strategic Policy Statements (SPSs) to drive robust decision-making

- SPSs can be a valuable tool in guiding regulators in the exercise of their judgement within the constraints of their statutory duties. Today's SPSs are a powerful and essential tool, but Government can make them a more effective driver of democratic legitimacy in the system of economic regulation.

- The Government must ensure that all regulators have an SPS. This is not currently the case for Ofgem.

- The sectoral SPSs should link to the regulators' statutory duties, and set out clearly how the Government expects each regulator to strike a balance between its duties to deliver the long-term infrastructure plan for each sector.

    - The SPSs should also set out how the Government expects the regulator to help deliver shorter-term Government priorities, and how these should be balanced against the drive to the longer-term objectives.

- SPSs should continue to be refreshed once a Parliament to ensure that the shorter-term Government priorities remain up to date. However, there should be a clear link from one SPS to the next to ensure transparency, consistency and predictability for regulators and industry.

- The Government should build on the current Open Letter and advance a formal cross-sectoral SPS that sets out the Government's expectation for how the regulators should collaborate to advance common challenges in their statutory objectives and sectoral SPSs.

    - Regulators should be required to treat the cross-sectoral SPS with the same status as a sectoral SPS, and be held accountable similarly for delivery against it.
    - Current priority areas for cross-sectoral consistency include issues such as cost of capital assessment and identification of consumer vulnerability. The Government should update these alongside sectoral SPSs as the external context evolves.

- We welcome the Government's intention for UKRN to drive the necessary consistency to boost predictability and certainty across sectors. However, the Government should consider upgrading the remit and resources of UKRN (potentially with the organisation put on a statutory basis, fully independent from the sector regulators) to enable it to deliver this objective.

Robust accountability mechanisms to maintain democratic legitimacy

- The UK's legal appeals regime provides certainty and predictability about how regulators will be held to account for their decisions. It is an essential part of what makes investing in UK regulated assets attractive to investors. Not only does it provide a means of redress for companies and investors in the event of regulatory error; it also ensures that regulators take decisions that they believe will withstand robust and rigorous scrutiny. We urge the Government to maintain its commitment to a merits-based appeals regime across the utility sectors.

- The Government should however follow through on its commitment to conduct a review of the operation of the appeals regimes across sectors, with an aim to introduce further consistency in the checks and balances on the use of regulatory discretion (e.g. the margin of appreciation the CMA affords regulators) so that regulators are held to the same standards for the same exercise of judgement.

- Accountability outside the legal appeals framework is also essential in driving the quality of regulatory decision-making, and is critical to helping maintain democratic legitimacy for the system of independent regulation. To help enhance the effectiveness of Parliamentary accountability:

    - Regulators should adopt measurable targets and metrics linked to the long-term infrastructure plan for each sector, statutory duties, and the Government's shorter-term priorities in SPSs, and report against these at regular intervals.
    - Relevant committees in both Houses of Parliament should have the remits and resources necessary to scrutinise the work of the regulators against their refreshed duties and SPSs. The committees should hold regular evidence sessions and set out well-defined reporting requirements for the regulators. The NIC should play an active role in enabling the committees to scrutinise the performance of the regulators, by analysing regulators' monitoring reports and lending expertise to committee inquiries where necessary.

Ensuring the regulatory framework incentivises the efficient delivery of high-quality infrastructure

Building sectoral frameworks to enable long-term infrastructure plans

- A fundamental principle – at the heart of each regulatory regime – should be to incentivise investment by ensuring that companies have a reasonable expectation of recovering efficiently incurred costs (including a return on capital), regardless of the delivery mechanism used.
  - While regulators need to maintain agility and flexibility to react to changing circumstances, they should do so within a framework that provides investors and operators with the certainty and predictability to invest over the long-term.
- In designing frameworks for delivery, regulators should continue to take account of consumer preferences to ensure that there is trust and support for the nature and pace of change.
  - However, regulators should be aware of the limitations of this type of evidence, particularly when it comes to incorporating the preferences of users of infrastructure that are not current bill-payers. In such circumstances, regulators will need to incorporate broader citizen interest directly into framework design.
- The regulatory stance should shift away from short-term outputs and outcomes to one aligned to the long-term infrastructure plan for each sector. This means adopting a regulatory stance which supports investment ahead of need if it is in the longer-term consumer and citizen interest.
  - Regulators should re-evaluate the existing balance in favour of short-term bills over investment. Where they have already done so – for example in fibre – the results have been impressive. Where the imbalance remains – notably in water and energy networks – much needed capital projects have been put on the back-burner. We agree with the Government’s view in the Energy Security Strategy that anticipatory investment can help lower bills over the long-term.
- As part of the shift to regulating for long-term outcomes, regulators should step back from constraining the exercise of discretion by company boards to make important corporate and financial decisions. Reflecting the regulatory tradition in the UK, the burden of proof should rest on the regulator to explain why any constraints, for example, on financial resilience, are necessary to avoid detriment to consumers or citizens.
  - -This will allow company boards and executive teams to focus more time on the strategic, operational and commercial decisions needed to achieve superior outcomes for consumers, and less on mitigating regulatory and policy risk.

Expand the role of the market to drive efficiency and innovation

- Competition should be injected into the regulated utility sectors where there is scope for it to deliver tangible consumer benefit. Given the characteristics of network industries, this is likely to take the form of competition for the market, rather than competition in the market.
- The Government and regulators should work together to determine the boundary of the competitive market in each sector. This should be rooted in sector-specific circumstances, and be based on an assessment of the to which competition for the market can enable the effective and efficient delivery of strategic investment in each sector.

- The Government should nominate an appropriate body to design and run awards for competed assets. These decisions should be rooted in sector-specific circumstances – for example, the new Future System Operator may be best placed to take on the role in energy networks, but there is no equivalent in the water sector, where companies may therefore be expected to do more of the tendering themselves.

- The Government should ensure that competition frameworks in each sector are designed with appropriate allocation of risk onto the party best able to manage it. This is critical to enabling efficient delivery at lowest overall cost to consumers over the long-term.

  - For some assets – particularly where there is tail risk that cannot be commercially borne by companies or investors – it may make sense for the Government to step in to take on the risk. Without this, assets that deliver important social / citizen value may never get built.

- Competition design and award frameworks should be technologically neutral and focused on clear, measurable outcomes (particularly on service performance, quality and resilience).

  - This will allow bidders scope to innovate and compete over technology to deliver defined outcomes.
  - Frameworks should be indifferent between the nature of the bidder – open to new entrants and incumbents, subject to a level playing field maintained through appropriate controls on conflicts of interest and operational and financial resilience (consistent with the requirements for operators of regulated assets).

- Competition frameworks should be designed to provide certainty over the long-term, ideally avoiding regulatory re-openers except in limited and well-defined circumstances.

  - To the extent possible, bidders for new assets should simply bid their required revenue stream over the lifetime of the asset, with that revenue stream remaining fixed in the event that the bidder meets the agreed outcomes.
  - However, some large and complex projects may require a bespoke framework (eg. through a regulatory asset base model) to ensure appropriate contract design and sufficient bidder interest to deliver a robust outcome.

Ensure the delivery of equivalent outcomes for assets not subject to competition

- For non-competed assets subject to ongoing regulation, regulators should simplify frameworks.

  - With much strategic new investment being delivered through competition, there is room to reduce the complexity of the regulatory framework. Regulators should roll back existing prescriptive regulation unless they can prove it is strictly necessary to protect consumers/citizens or drive efficiency. Similarly the range of performance commitments and incentive mechanisms should be simplified.
  - Any regulation retained in the rulebook or added over time should be subject to a robust cost-benefit analysis assessment conducted over a long-term horizon considering costs and benefits to both consumers and citizens.
  - Particular focus needs to be given to areas where regulators have added prescriptive regulation in recent years, such as on financial and operational resilience. Regulation in these areas has been extended to address concerns that external shocks may impair the ability of utility companies to provide services to consumers and citizens. In some cases – such as retail energy where barriers to entry are low – there has arguably been too little intervention on financial structures. But in other areas – for example asset-heavy network businesses – there is a risk that regulators try to exert too much control on financial structures, reducing the scope for companies and investors to make choices which would improve efficiency and consumer outcomes.

- The approach to designing price controls should shift away from delivering outcomes over a five-year horizon.
    - Regulators should design price controls (outcomes, performance commitments, incentives) in a way that spans multiple review periods. This may mean abandoning core elements of the existing approach (with a regular re-basing of performance and setting outcomes every five years) to one which is more flexible and adaptable but still protects consumers over the long-term and incentivises efficiency. But there should be a commitment to simplicity over prescription, and a predictable approach to risk allocation between companies and consumers. UKRN should help drive consistency in the re-design.
    - Regulators should facilitate innovative approaches that current regulatory frameworks do not incentivise, if there is evidence that these would be in the long-term consumer and citizen interest. This includes partnerships and nature-based solutions.
    - The Government should build on its existing plans (via the UKRN WACC Taskforce) to drive a consistent methodology to the elements of the cost of capital – shared across sectors, where possible. Parameters should only be updated at each price control period if absolutely necessary, with the Taskforce taking a cue from CMA determinations.
- Regulated companies should set out detailed long-term delivery plans that will enable them to deliver the target outcomes within the revised regulatory frameworks in each sector.
    - This should include a detailed consideration of the potential use of innovative solutions in line with the changes to the regulatory framework.

Driving affordability to ensure the system delivers for all parts of society over time

Identify groups that need targeted assistance and getting it to them

- While regulators and companies have made significant progress in recent years to help support vulnerable customers, the backdrop of the cost of living crisis means that companies know they need to improve identification and targeting to mitigate serious harm – ideally before it arises. But this requires policy and regulatory change.

- Each sector has a different approach to identifying vulnerable customers, based on siloed datasets and definitions. Companies therefore struggle to build a holistic picture of a consumer’s financial position, making it difficult to identify and address transient vulnerability.

- Uncertainty over the regulatory approach to data sharing has prompted regulators and companies to adopt a cautious approach. This has held back the development of innovative solutions.
    - As part of the Government’s wider review of the data protection regime post-Brexit, the Government should assess the barriers to data sharing and pooling across utility sectors. The goal should be policy and regulatory change to facilitate the development of a shared, cross-sectoral database of indicators to identify customers in vulnerable situations.
    - The ICO and utility regulators should work together to create an ICO sandbox that companies can participate in to trial and showcase solutions that could be realised if regulatory barriers were lowered. This will provide valuable evidence to help the Government design a new proportionate, flexible and innovative regulatory regime.

Equitably distributing costs of increased investment within generations

- Policymakers and regulators have historically not had to grapple with questions over the fair allocation of cots between consumer groups.
-
    - The prevailing approach has been for customers to face the same prices if the service providers' cost to serve them is the same.
    - This has been adapted only in very specific situations (e.g. prepayment meters, social tariffs).

- However, the significant volume of investment over the coming decades, set against the very real affordability challenges for large sections of consumer groups, means that this issue will need to be addressed. The delivery of the long-term infrastructure plan in each sector needs to be funded in a way that spreads costs fairly.

- While HM Treasury's cost of net zero review is a helpful initial step in the energy sector, it does not confront important questions about how transformational infrastructure will be paid for.
    - The Government must commit to a serious review across sectors, setting out its expectation for how costs will be borne – between taxpayers and different groups of consumers – in each sector. Such decisions will have significant distributional impacts and cannot be made by regulators. It is important that there is a consensus across society for this important question to ensure enduring legitimacy for a difficult set of decisions.
    - The Government should develop guidance for principles that regulators should follow to ensure that operators' pricing structures reflect the Government's preferred distributional profile, in line with the outcomes of the Government review.

- Once there is a clear understanding of what the Government considers a fair and equitable distribution to be, regulators should ensure their competition and regulatory frameworks are designed to give effect to them.

    - Regulators should enable (or where necessary require through the design of price controls) companies to develop targeted tariff frameworks (e.g. social tariffs or differential usage rates) in line with the overall balance in each sector set out by the Government.
    - UKRN should play a role in ensuring consistency in methodologies across sectors (where relevant).
    - Regulators should be required to report on the distributional impact of these steps, and assess compliance with the Government's expectations for each sector.

Building intergenerational fairness into the regulatory framework

- Regulators should adopt a decision-making framework for investment that is aligned with the horizon of the long-term infrastructure plan.

    - This means incentivising and permitting investment ahead of need if there is a reasonable prospect of the necessary infrastructure being built at lower overall cost and/or more innovative build. Regulatory decisions should recognise that the risks to future generations of inaction now are substantial and outweigh the relatively small risks of asset stranding.

- Regulatory asset bases reflect specific assumptions around the useful economic lives of assets. Capitalisation and depreciation rates determine how the costs of assets are spread between users over time.
    - There is no perfect approach to establishing these rates, but in principle the costs of assets should be recovered over the course of their useful lives in line with the level of asset utilisation. This would mimic the way competitive markets tend to operate. In current regulatory practice, the link between asset lives and prices is weak which has direct consequences for intergenerational fairness.
    - Regulators should review the current link between prices over time and asset usage, given the step-change in investment expected in the coming years.
    - The commissioning of assets through competitive processes should adopt a similar principle. The owners and operators of competitively procured assets should expect to recover the costs of those assets broadly in line with the economic value of the assets over the asset lifetime.

ANNEX 2: SUMMARY OF STAKEHOLDER CONVERSATIONS

Steven Hobbs, Senior Policy Manager, Consumer Council for Water

- Consumers value and understand that long-term challenges need significant investment, but we need an open conversation regarding the bill impact to keep consumers on-side.

- There is room to improve the quality and use of consumer engagement, so that consumers better understand the short and long-term impacts of regulatory and investment decisions. There is a big challenge to incorporate the views of future bill-payers into decisions made today that will affect them.

- Tackling vulnerability and affordability will be the most pressing challenges in the coming months and years. Cross-sectoral consistency could be very helpful to companies in enabling them to do more (e.g. through a single register of vulnerable consumers).

- Price control design should evolve to encourage long-term thinking from companies. But it needs to be done in a way that ensures that consumers see the value, rather than companies reaping rewards from incentives at the expense of consumers.

Rocio Concha, Chief Economist and Director of Policy and Advocacy, Which?

- Consumers value both price and quality attributes for infrastructure. Having a conversation focussed on the latter is important to build a societal consensus and consumer trust for investment. It can be difficult for consumers to grasp concepts such as intergenerational fairness, clear and simple communications can help.

- There is room for cross-sectoral consistency and sharing of best practice in addressing vulnerability across sectors. Need to be realistic that there are challenges here with data sharing (transient vulnerability, data protection) but there are also opportunities to make better use of the data available by Government and businesses to identify and support vulnerable groups.

- Need to review our institutional structures to ensure they are supportive of long-term thinking – need the right regulators, right duties and right people. There is room for regulatory duties to be simplified, more consumer-focused and made clearer to help regulators prioritise, within a longer-term strategic direction for each sector. Challenge is to find a way to make regulators more accountable, but give them enough flexibility to react to developments, while maintaining their independence and consumer trust.

Gemma Tetlow, Chief Economist, Institute for Government

- When expanding the role of the market in infrastructure delivery, need to make sure we are learning lessons from recent years on when and how competition works.

- The question of how needed infrastructure spending is going to be funded is still unanswered. Need to urgently resolve the issue of the fair way to spread costs both within and across generations. Government needs to be systematic and clear about the answer across sectors – cannot keep deferring the decision.

- It is important to safeguard regulatory independence, but regulatory objectives need to be aligned with government policy to maintain legitimacy. It is not clear whether this is the case for some of the big challenges facing government policy, such as net zero.

- There is room to improve the way the public and private sectors work together to allocate risk. Taxpayers and consumers should not pay over the odds for the private sector to take on risk that the public sector is better off facing.

Duncan Symonds, Fellow, Institution of Civil Engineers

- The programme of policy change needed to deliver certainty and predictability for widespread investment does not need any new institutions to be created – need to ensure existing institutions and regulatory structures have the right duties and powers.

- The NIC should have a more central role in helping the Government define the framework for enabling infrastructure delivery. It could also help bring about greater regulatory accountability by enabling consistent scrutiny of regulators from Government and Parliament.

- Predictability and certainty of the UK regulatory framework has historically been a significant attraction for investors – but this has been eroded in recent years. Regulation needs to dampen rather than exacerbate external volatility.

- Intergenerational fairness and affordability issues both very significant. Regulators should look to enable and incentivise innovative ways to reduce overall cost needed to achieve desired outcomes – eg nature-based solutions. Regulators may need to provide flexibility over the short-term in order to enable innovation that drives cost down and service quality up over the long-term.

John Penrose MP

- Regulatory duties and SPSs go hand in hand. If duties are more clearly and carefully drafted, there is less weight on the SPS to channel the use of regulatory discretion to achieve policy goals.

- The Government needs to make better and more active use of Strategic Policy Statements to ensure that they achieve their desired objectives.

- Need the right institutional structures to realise the results of cross-sectoral consistency in areas such as cost of capital determinations. Could see benefits if UKRN is properly empowered and resourced rather than relying on the member utility regulators.

- Where possible, consumers should be empowered with choice, backed up by stronger enforcement to ensure the benefits of competition can be realised.

Global Infrastructure Investor Association

Promoting Private Investment in Infrastructure

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