

# New Energy and Water Public Interest Network New-Pin

**Energy and water:  
How effective is your board in delivering ‘future  
customer’ and wider stakeholder outcomes?**

A Sustainability First check-list for  
energy & water board effectiveness

Annexes 1-4

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**Sustainability** *first*

# Annexes

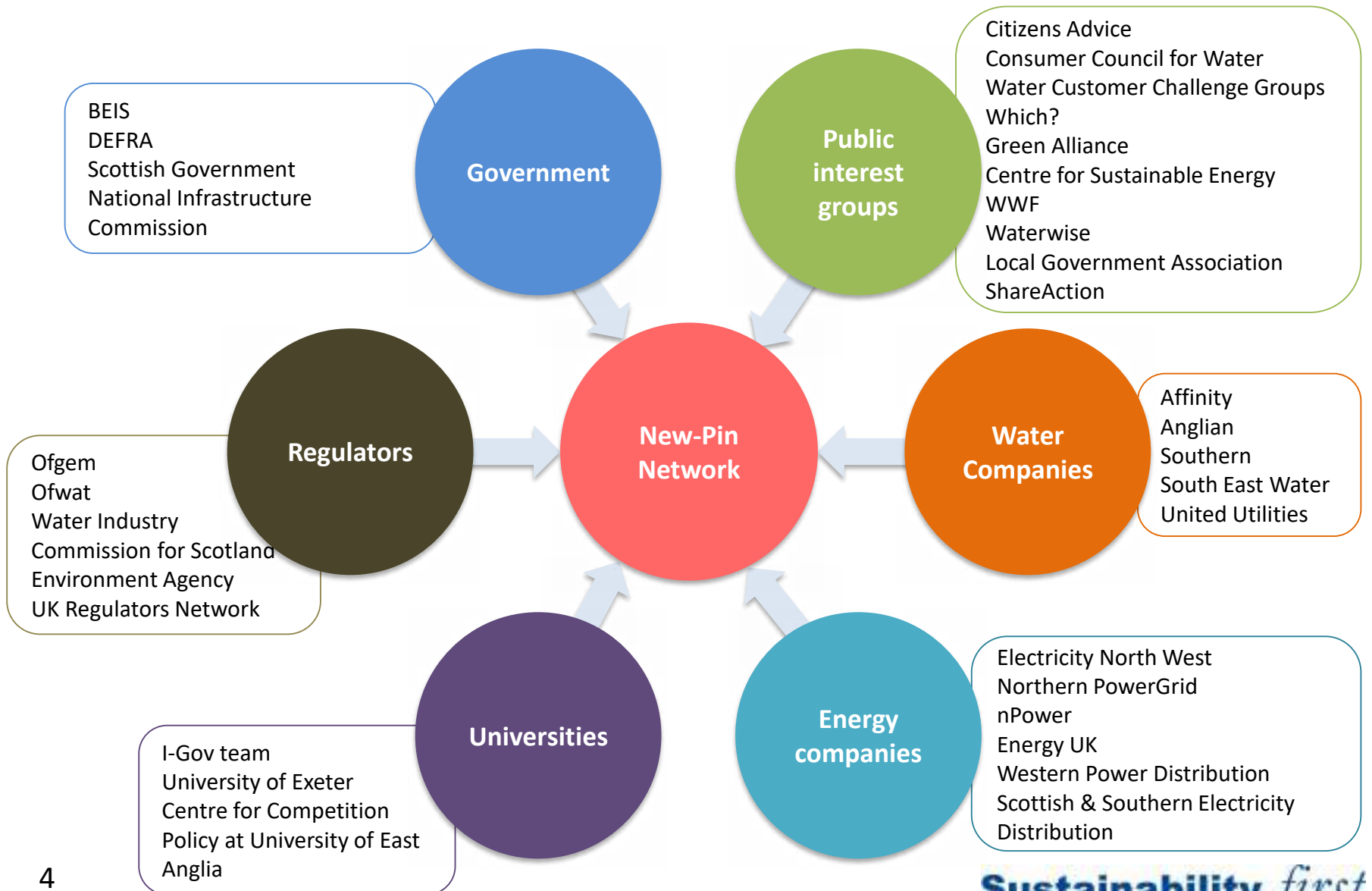
These Annexes contain some generic information on governance. We've included this to be comprehensive & inclusive in our approach

1. New-Pin: overview and objectives for governance work
2. Definitions: governance; the role of the board; and corporate structures
3. New-Pin approach to governance and research methodology
4. Energy and water: why specific focus on governance in energy and water and sector specific requirements
5. Key findings, different perspectives and case study insights from elsewhere
6. The changing corporate governance landscape

# Annex 1: About New-Pin

- The New Energy and Water Public Interest Network ('New-Pin') - a ground-breaking project
- We are building understanding and consensus around long-term public interest outcomes for the energy & water sectors
- The Network (see next slide) is building a 'common voice' for greater long-termism
- We have examined how to balance short- and long-term pressures for the sectors - on specific 'difficult' topics
- New-Pin provides a framework and 'tools' for stakeholders – to help step-back and explore big picture / strategic risk
- The energy and water sectors have strong inter-dependencies. These need to be better understood / managed
- Sharing lessons and case studies. Spreads good practice across both sectors. Avoids repeat mistakes

# Annex 1: New-Pin – Who's involved?



# Annex 1: Objectives for New-Pin governance work

*What we seek to achieve in energy & water sectors in terms of governance*



# Annex 2: Definitions

## Governance and the role of the board

**Corporate governance:** The system of statute, rules, practices and processes by which a company is directed and controlled. It is about what the board of a company does and how it sets the culture, values and ethics of the company

**Board of directors:** Group of executive and non-executive Directors elected by shareholders to govern company

**The role of the board:** Within this framework, the board exists to promote the long-term success of the company by collectively directing the company's affairs for the benefit of its members as a whole. In doing so, its directors must have regard to: the likely consequences of any decision in the long-term; the interests of a range of stakeholders (including employees, customers and the company's community and environmental impact); the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly between members of the company (**S172, UK Companies Act 2006**). Boards clearly have a key role in setting the strategic direction of the organisation. On its own the board can't deliver long-term public interest outcomes. This is a joint responsibility with the executive

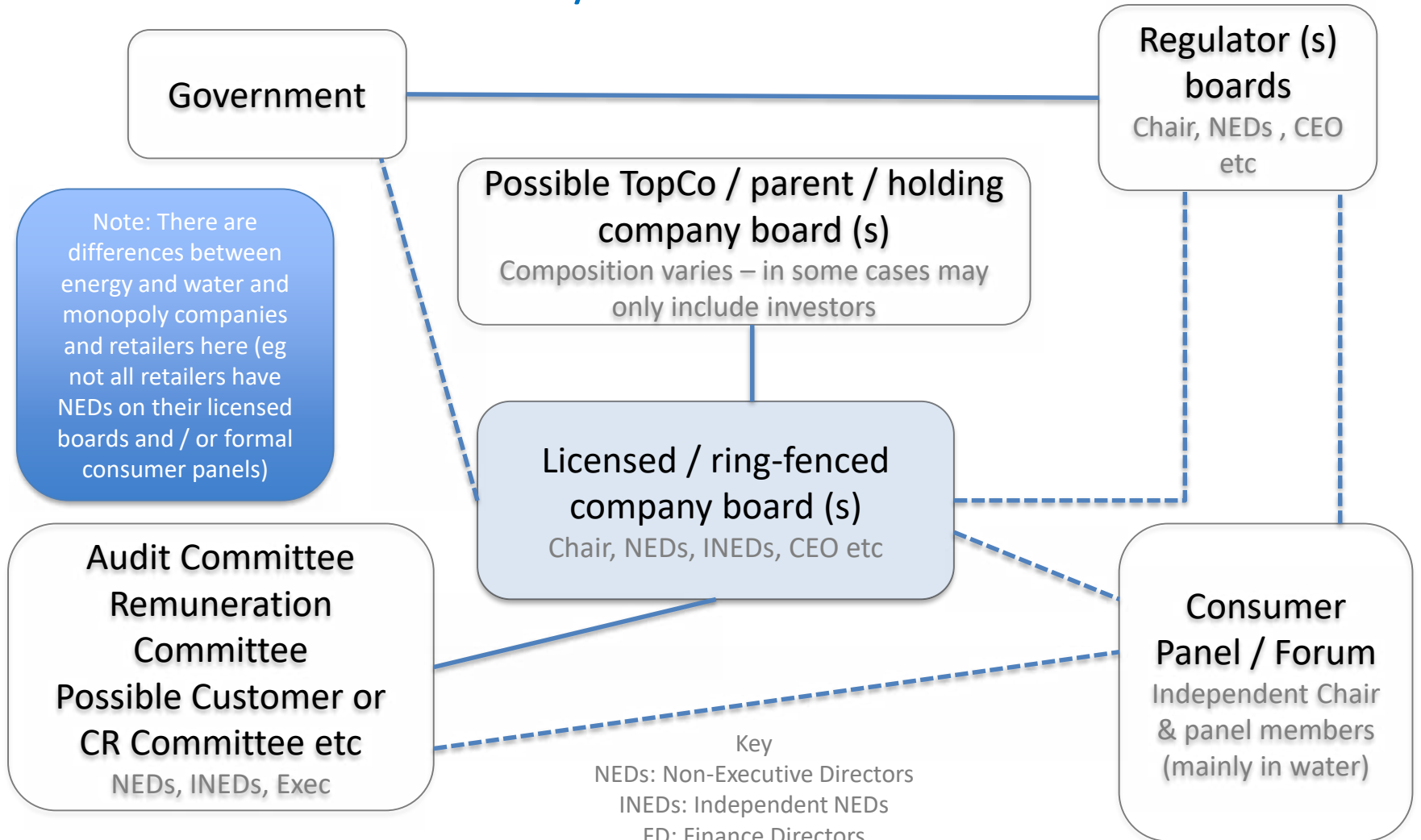
# Annex 2: Definitions

## Corporate structures in the energy and water sectors

- There are a mix of corporate structures in the energy and water companies operating in the UK. This check-list is aimed at the full range of ownership structures. However, some of the points raised may be more relevant to some structures than others
- A minority of energy and water companies today are Plcs – listed on the stock exchange
- Listed companies have specific formal reporting requirements (in terms of the Corporate Governance Code and holding events such as Annual General Meetings)
- Most energy and water companies are the licensed businesses of larger, often international, groups (which may / may not be listed)
- In many energy companies, the licensed businesses are accountable to the group TopCo / parent / holding company (in this slide set, we use the term TopCo for these companies)
- For illustration, the next slide provides a high-level example of a ‘typical’ generic corporate structure in the UK energy and water sectors
- The solid lines indicate a firm line of accountability. The dotted lines indicate a more informal reporting line / relationship
- In water, Ofwat licenses require the board of the regulated company to be the leading company and have full control of the business (see slide 37) – although some matters may still require TopCo / shareholder approval
- Welsh Water, a mutual, and Scottish Water, that is state owned, have slightly different group structures. The Group Structure of Welsh Water is outlined in slide 32 as an example
- It is important to note that all types of corporate structures, including not for profits, have advantages and disadvantages

# Annex 2: Definitions

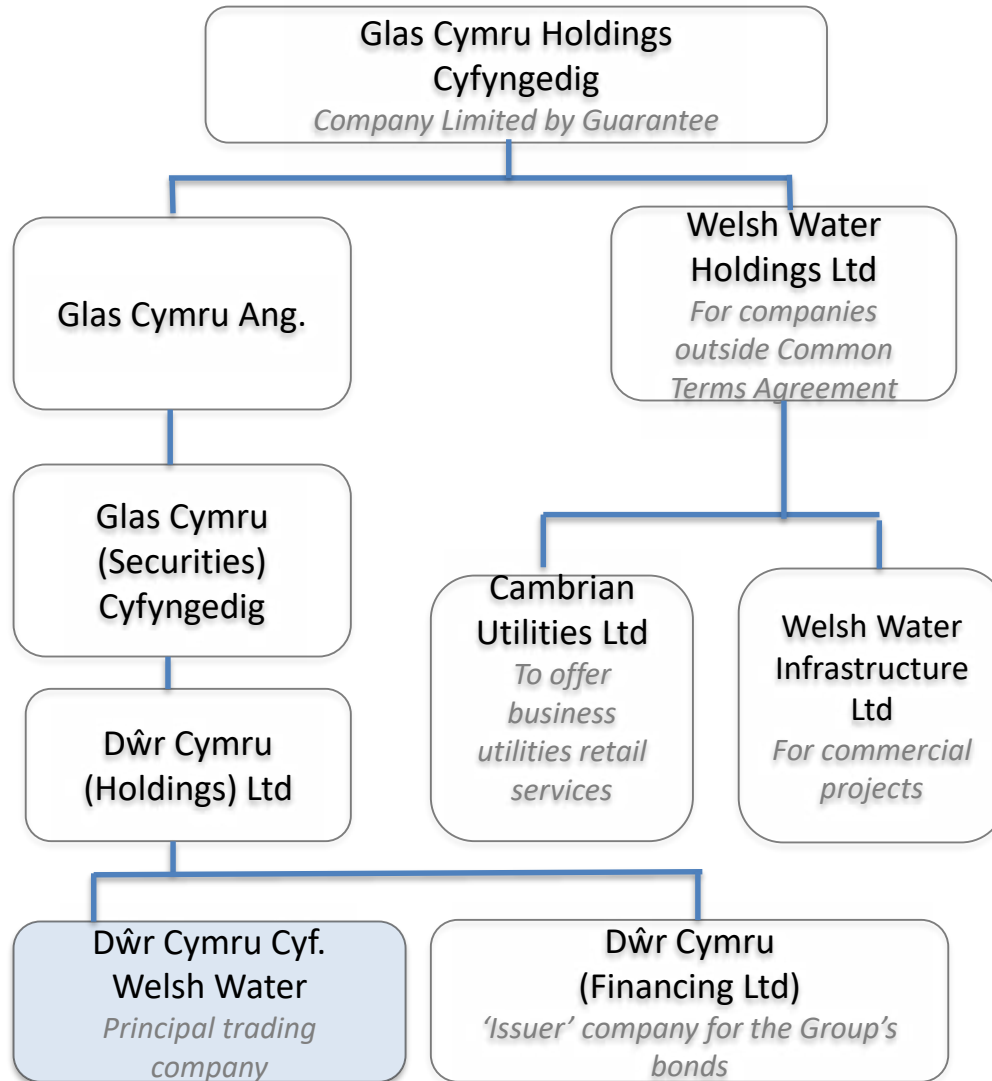
## High level example of a 'typical' corporate structure in energy / water sectors





# Annex 2: Definitions

## A not for profit example - Group structure of Welsh Water



*Glas Cymru members fulfil the role that shareholders would normally play in corporate governance. They attend the AGM; electing the Dŵr Cymru Board and approving their remuneration report*

*The members' role is to ensure that the company is focused on its primary purpose; to provide efficient high quality and affordable water and sewerage services to Welsh Water's customers, both current and future. They ensure good stewardship of the company's assets*

*Members are appointed by the board but selected by an independent member Selection Panel. Membership is personal; members do not represent any groups or stakeholders. Members meet formally twice a year and are unpaid*

*In 2016, Welsh Water engaged its customers as to how best to use the £30m that in a private company would have gone to shareholders. They received 12,000 responses; 'When people knew it was a not for profit company they were more content for the money to be used for community and environmental projects'*

# Annex 3 Approach and research methodology:

## Research methodology for this slide set



- New-Pin's work in this area is firmly focused on UK energy and water companies and their regulators and what is distinctive in corporate governance terms for these sectors
- This slide set is based on 26 interviews with senior energy and water leaders (see next slide) and a brief literature review
- Comments were received on the draft from interviewees and New-Pin members
- The slide set clearly shows that there are differences in views and particular interests
- There are also differences between the sectors, with a more formal approach to board engagement with consumers in the water sector
- Both sectors are changing
- It takes time for cultural change to have an impact – even when it is led from the top
- We shouldn't be surprised if some of the changes in 'the way we do things round here' have yet to be reflected in the views of some of those we interviewed

# Annex 3: Approach and research methodology – New-Pin governance interviews

*Between November 2016 and July 2017 we have interviewed a mixture of current and past Board members*



*All interviews were non attributable*

# Annex 4: Why our specific focus on governance in energy and water

Slides 8 and 9 have highlighted why governance is important in energy & water. This slide explores some of the wider reasons why this is the case. The following two slides then outline the specific governance requirements in each sector

## Trust (Edelman Trust Barometer, 1/17)

- Trust in institutions & wider systems & processes is ‘imploding’
- Barely 1 in 10 people believe ‘the system’ is working for them
- 73% agree that businesses are expected to lead

## Fairness

- Brexit and the 2017 election have raised fundamental questions about how ‘fair’ our society is and how much control people want; individually, locally, nationally and globally. Boards of regulated companies providing essential services will be considering the relevance of these questions to their work
- The draft Industrial Strategy (1/17) highlighted issues of fairness between places
- Pre 2017, BEIS planned a Green Paper on ‘Markets that aren’t working fairly for consumers’ – including the energy market. That thinking is now reflected to some extent in letter from Secretary of State to Ofgem on 21<sup>st</sup> June
- NAO Report on ‘Vulnerable consumers in regulated industries’ (3/17) identified need for regulators and government to work closer together to clarify their responsibilities to support vulnerable customers
- Increasing interest in ethical business regulation (Professor Christopher Hodges, paper for BEIS 2016) and conduct regulation (Professor George Yarrow, RPI Conference, 5/17)

# Annex 4: The governance landscape- Water

## **DEFRA**

The Government's strategic priorities & objectives for Ofwat (3/17):

- Should challenge sector to plan & invest to meet needs of current and future customers, in a way which offers best VFM over long-term
- Should embed priorities & report on progress to its Board and through its Annual Report and Accounts

## **Ofwat – Governance Codes**

Water companies need to have a Governance Code in place that they are compliant with (from 4/15). Principles:

- Reporting must be transparent
- Regulated company must act as if it is a separate public listed company
- Significant independent representation – INEDs
- Boards should have appropriate balance of skills, experience etc
- The Chair must be independent of

- management and investors
- Board committees, including audit & RemCo's, will operate at regulated company level with majority of independent members
- The group structure must be explained simply and clearly

Assessed company governance arrangements (6/15): improvements.

Separate principles for holding companies include transparency, managing risk and supporting long-term decision making: less progress.

## **Example - Holding Thames Water to Account**

In 6/17 the Chair of Ofwat asked the company to adopt 5 commitments re: customer communication; how co. sets aspirations & performs; transparency & clarity of financial returns; board composition; & management rewards

# Annex 4: The governance landscape - Energy

## BEIS

- The Energy Act 2013 introduced the concept of a Strategy and Policy Statement for Ofgem
- When designated by Parliament this will 'set out the government's strategic priorities for the energy sector and the policy outcomes Ofgem needs to achieve in relation to those priorities' (Ofgem 3/16)

## Ofgem

- Currently have separate governance requirements for retail and monopoly businesses

## Ofgem: Retail market

- Principles Based Regulation is placing increased focus on company conduct

- In 6/17 Ofgem published its final proposals on the Standards of Conduct that sit in front of supply licences for retailers' relationships with their customers. These included a revised fairness test focused on outcomes rather than process & new principles on 'informed choices' & 'vulnerability'
- Retail boards must be ready to meet these new requirements

## Ofgem: Monopoly networks

- Ring Fence Conditions in Network Operator Licenses (4/13) require operators to have two 'Sufficiently Independent' Directors where their fiduciary duties are paramount

For further information about Sustainability First, New-Pin or to get involved in our forthcoming project on '**public interest compacts**' for energy and water companies, contact

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