

Sustainability *first*

Beyond window dressing

Putting customer, future consumer and wider stakeholder interests at the heart of company and regulatory decision making

A perspective from the UK energy market

Sharon Darcy

Gill Owen Memorial Lecture

7th February 2018

Overview

- Sustainability First
- The long-term public interest in energy
- What is public engagement and why is it important in energy?
- A snap shot of UK energy markets
- How effective has public engagement been?
- Disruptors to existing engagement approaches
- Linking engagement and governance
- Increasing board effectiveness in delivering against public interest challenges

Sustainability First

Promoting practical, sustainable solutions to improve environmental, economic and social well-being since 2000



Gill Owen was one of our founding colleagues

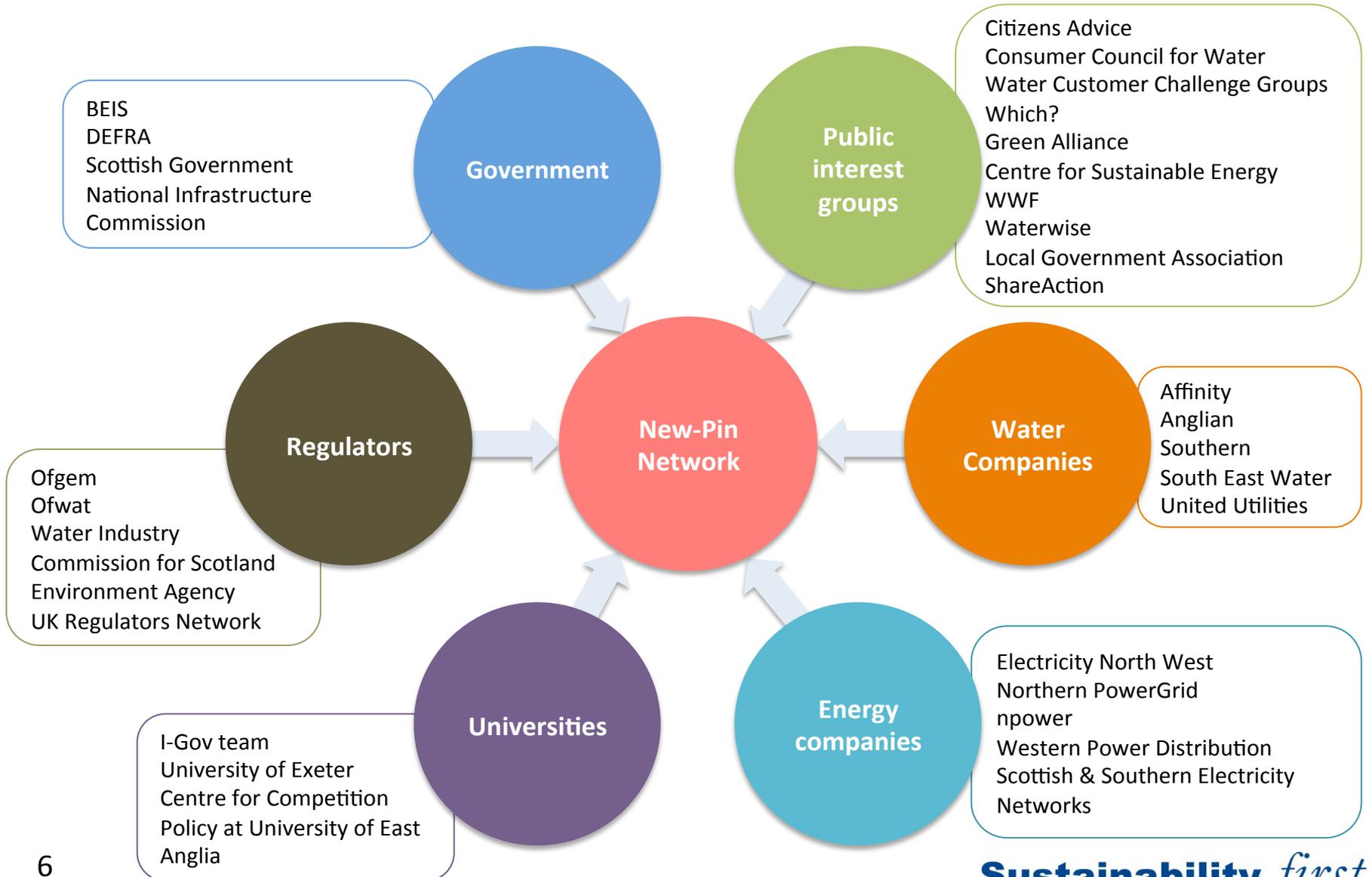
Sustainability First projects

- **New-Pin** – New Energy & Water Public Interest Network
- **Project Compact** - What more can energy and water companies do to better manage the politics of fairness and the environment? Creating stakeholder Public Interest Compacts
- **Inspire** – Innovation & Energy Customers in Vulnerable Circumstances
- **Public Interest Advisory Group** - Smart meter energy data
- **Power Responsive** – strategic support to National Grid for business Demand Side Flexibility Group
- **Future thinking** - Discussion papers & round-tables on issues such as: Sticky Customers and what this might mean for the move to smart; and smart tariffs & fairness

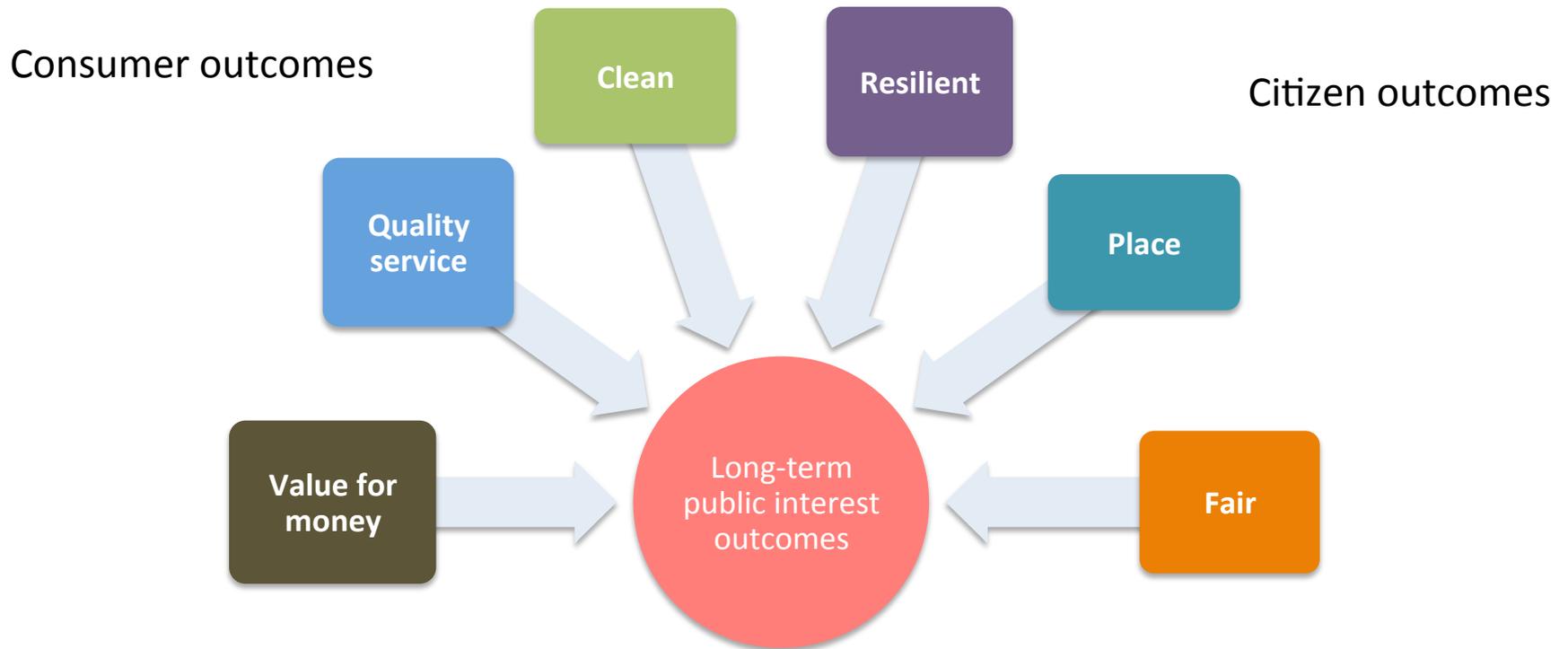
About New-Pin

- The **New Energy and Water Public Interest Network ('New-Pin')** - a ground-breaking project established in 2015
- Used **deliberative engagement** to build understanding and consensus around **long-term public interest outcomes** for the energy & water sectors and a 'common voice' for greater long-termism
- A participative, inclusive and 'democratic' approach to addressing the challenges faced by the energy and water sectors
- Examined how **to balance short- and long-term pressures** for the sectors - on 'difficult' topics: long-term affordability; resilience; trust and confidence; market approaches; innovation, regulation and Government interventions; and engagement
- Extensive work on corporate governance in energy and water companies
- Sharing lessons and providing '**Agendas for change**' for stakeholders – to help step-back & explore strategic risk in a practical way

New-Pin – Who's involved?

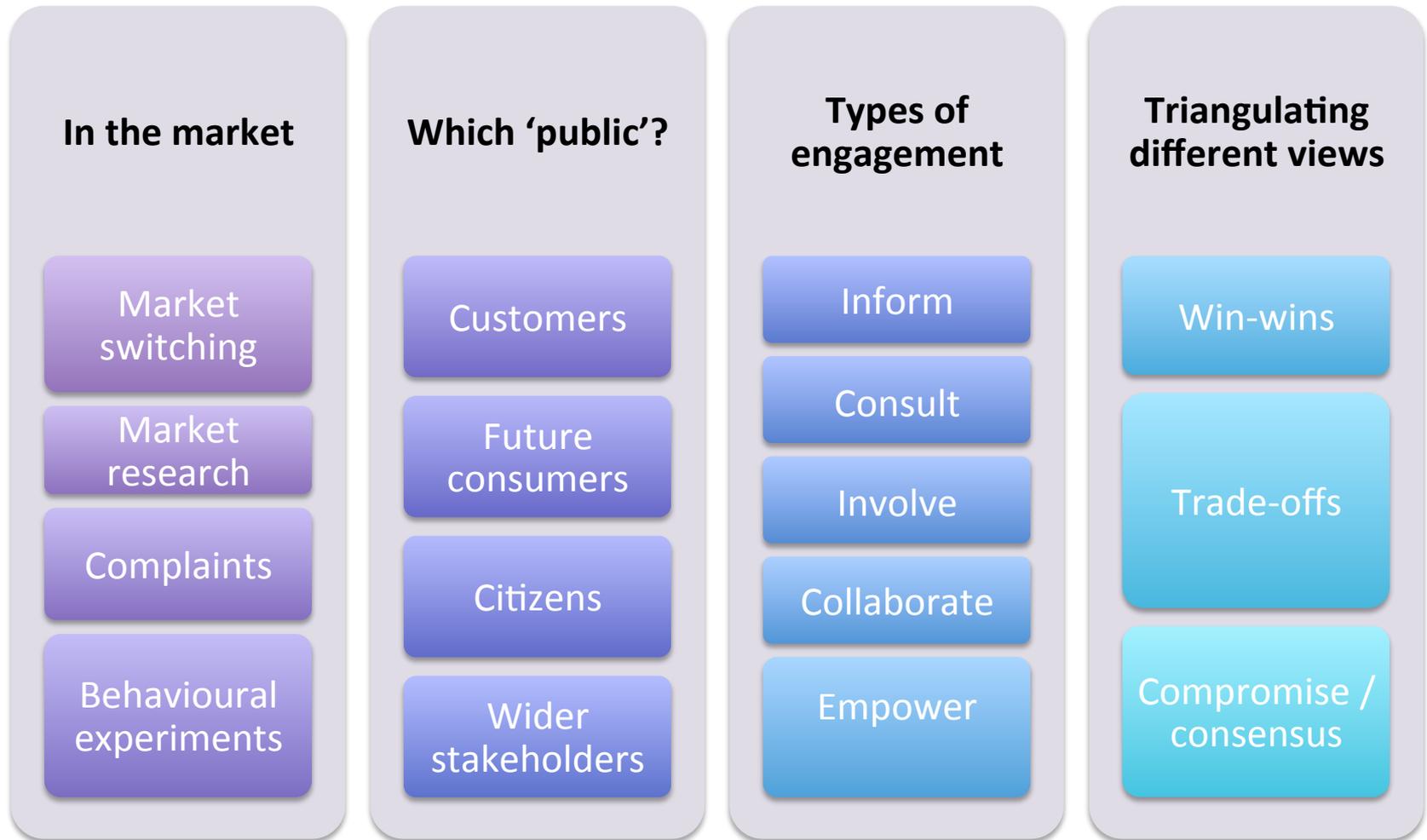


What is the long-term public interest in energy & water?



The public interest is the amalgamation of consumer, citizen, investor and wider stakeholder interests – for both today and tomorrow

Public engagement – an overview



Engagement - specific issues in energy (i)

Inertia

- Risk aversion
- Used continuously
- Essential service - high loyalty

Potentially complex decision making chains

- Energy used through other appliances eg boilers
- Principal agent problems – especially in growing private rented sector

Different consumer segments, different needs

- People in vulnerable circumstances
- SMEs
- I&C users
- Pro-sumers
- Active communities

Engagement - specific issues in energy (ii)



How do you 'frame' the issue / draw the boundaries? Recognise inter-dependencies & systemic risks



What's an appropriate time-frame for delivery?
My revolution may be your evolution

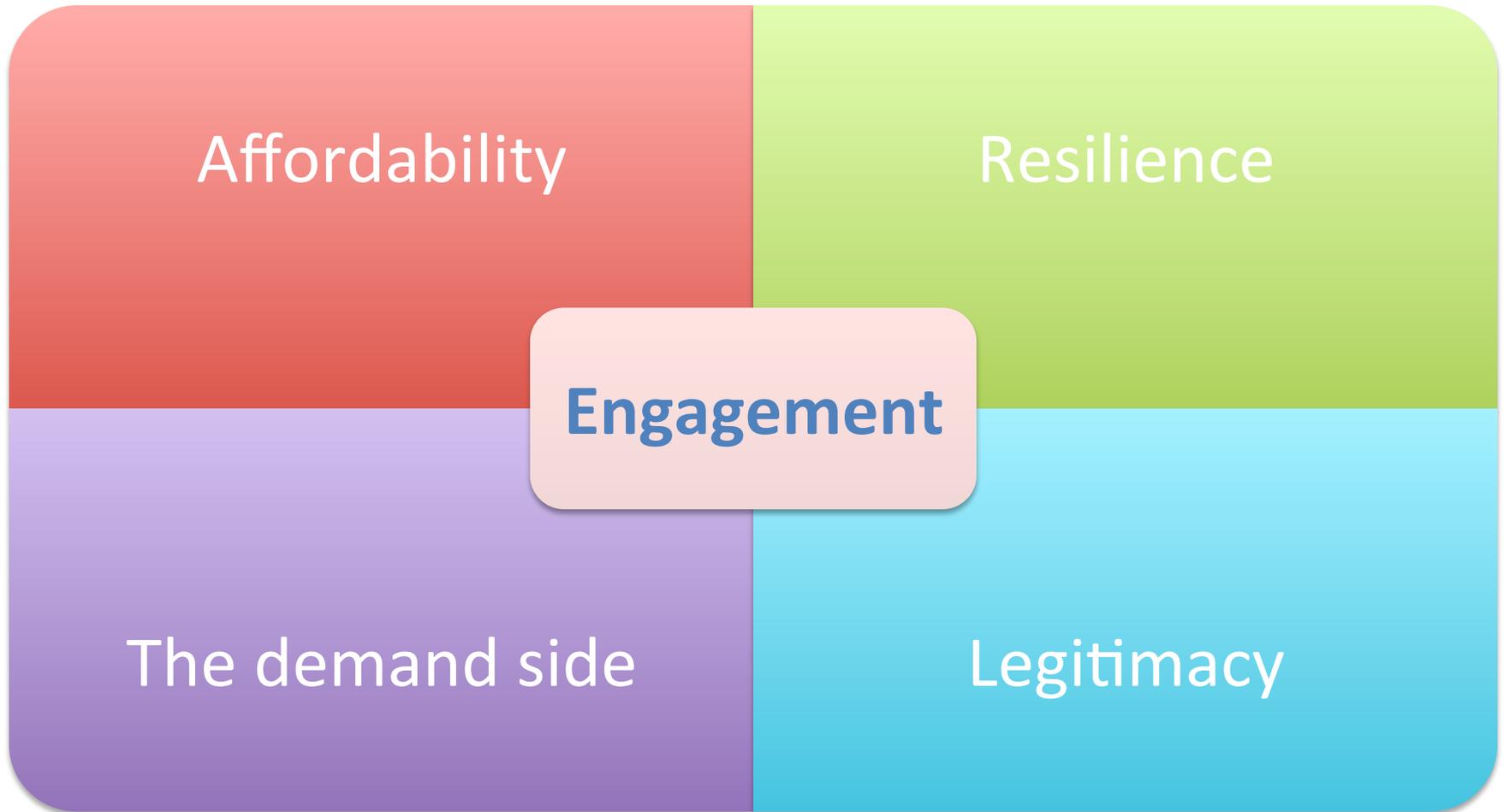


What's fair / who pays for what? Within and between generations?

Why public engagement is important – delivering public interest outcomes (i)

- Leads to better services that meet real needs and provide the outcomes that people want – not what ‘technocrats’ or ‘engineers’ think they need
- Ensures strategies and plans are more responsive to changing requirements

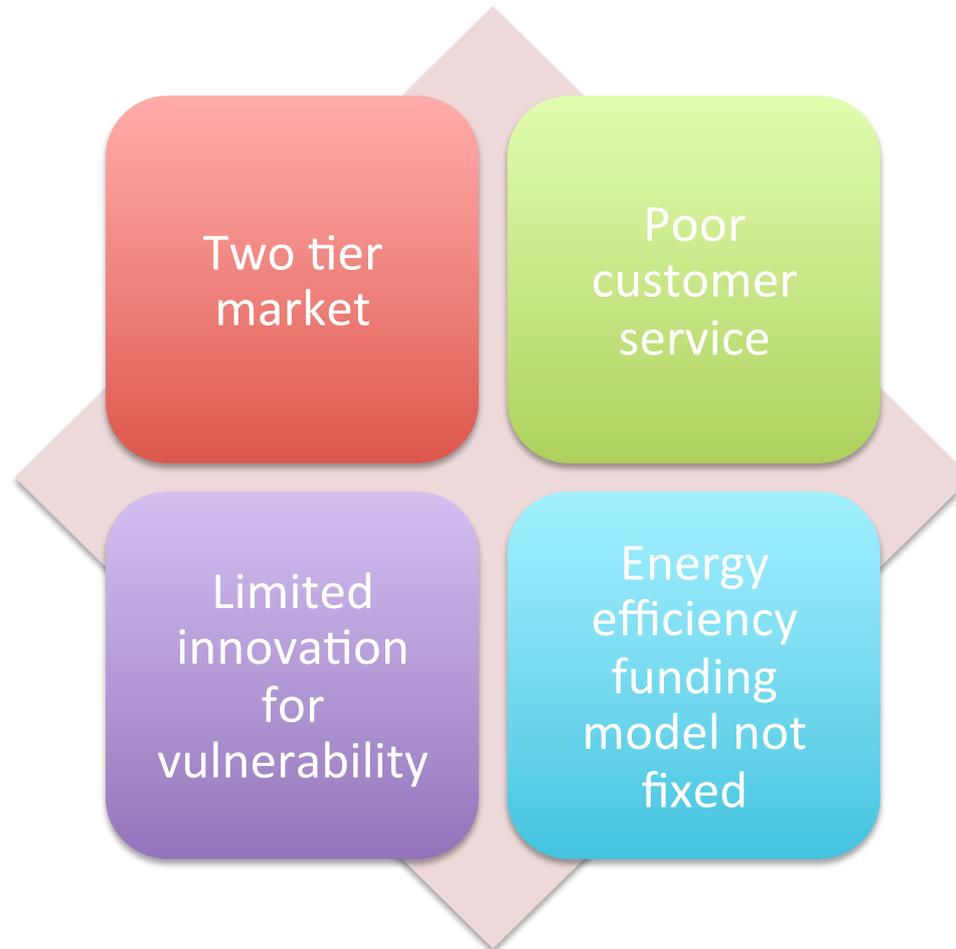
Why public engagement is important – delivering public interest outcomes (ii)



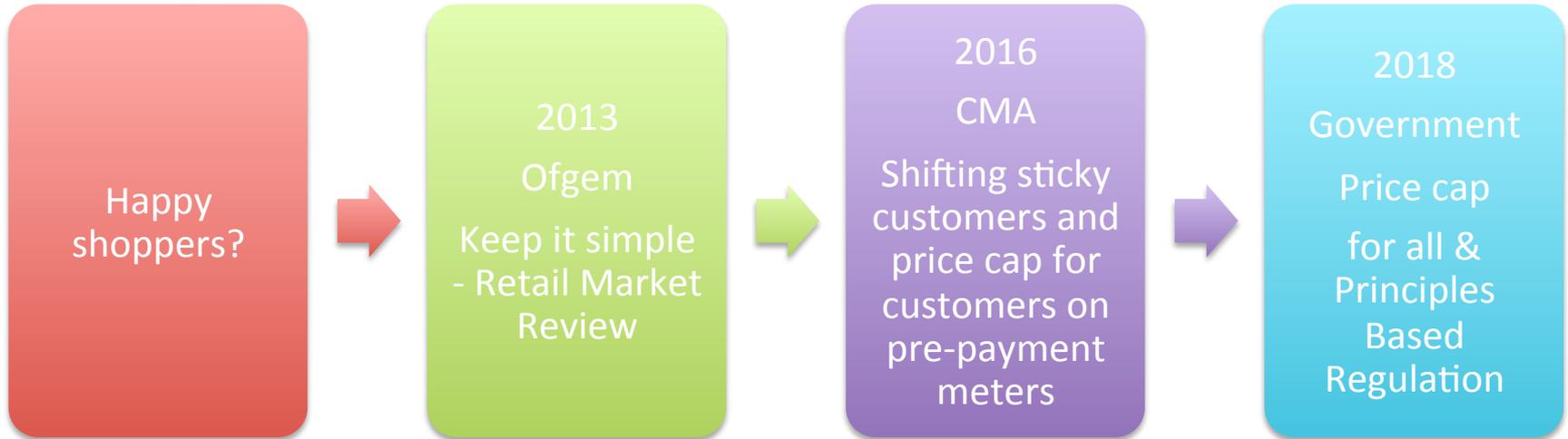
What's all this got to do with regulators?

- When there is imperfect competition / monopoly engagement is unlikely to happen without
 - Effective conduct regulation
 - Regulatory incentives
- But
 - Governments need to provide the vision
 - Companies need to own their relationships with their customers and manage their risks

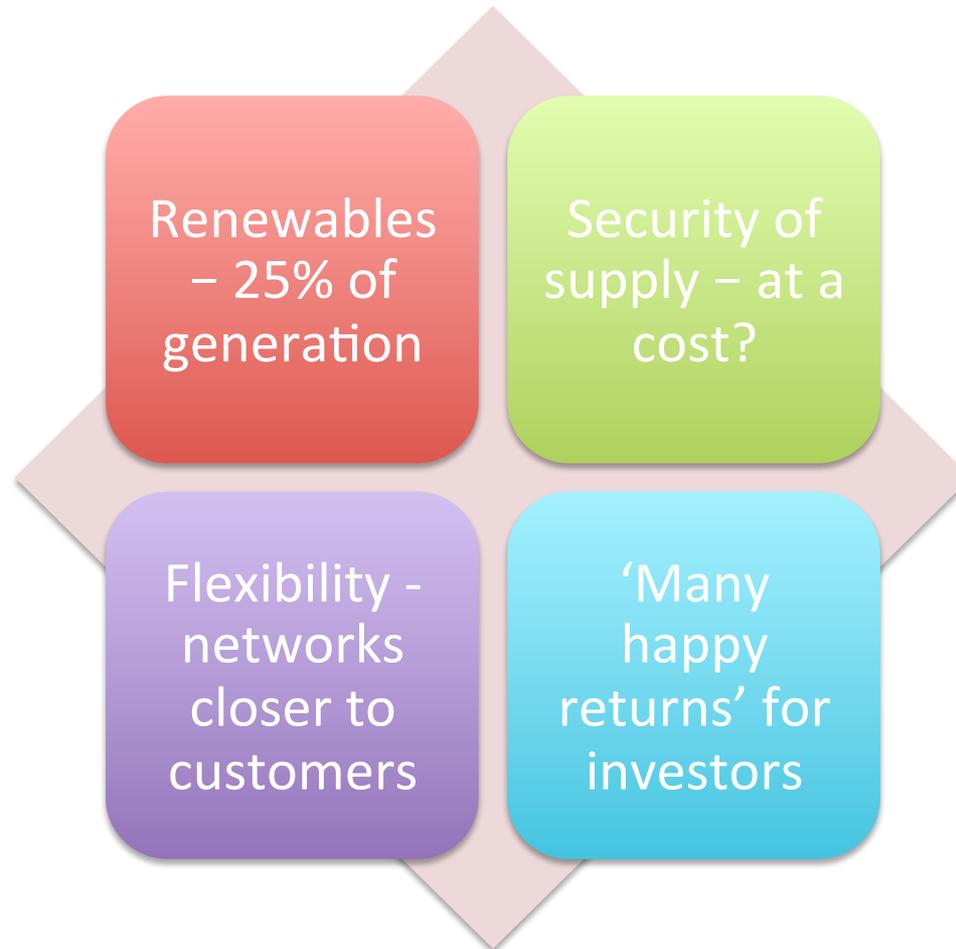
Snap shot of UK retail energy markets - sticky customers & poor services (i)



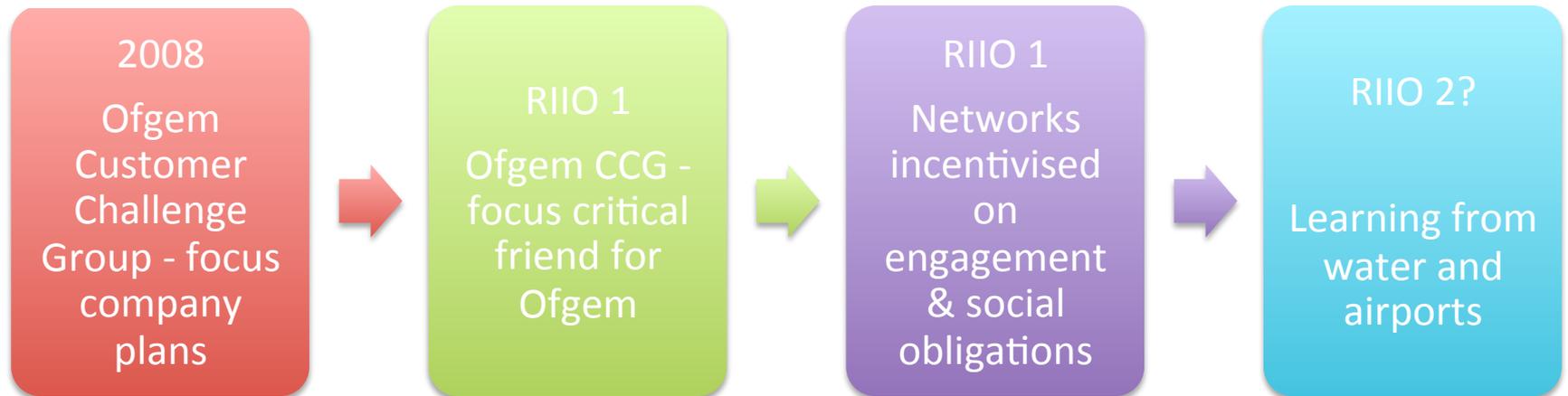
Snap shot of UK retail energy markets – the evolution of engagement (ii)



Snap shot of UK generation and networks– renewables leading to greater focus on customers (i)



Snap shot of UK generation and networks– the evolution of engagement (ii)



Engagement in elected other UK regulated sectors

Financial Services Consumer Panel
Within but independent of regulator

Advice to the regulator

Water (England and Wales)
Independent Customer Challenge Groups in companies

Assurance on quality of engagement in business plans

Heathrow airport Consumer Challenge Board
Convened by the regulator

Challenge and scrutiny that business plan has been informed by engagement process

Water (Scotland)
Customer Forum
Convened by the regulator

Negotiated settlement of strategic review of charges

How effective has engagement been in energy?

- **Improvements in current customer focus**
 - Eg innovation for vulnerability when this has been incentivised
- **Lack of clarity on goals / purpose**
 - Difficult to manage expectations or to evaluate impact
- **Engagement still often seen as a ‘bolt on’ compliance exercise**
 - Not embedded in decision making
- **Little formal evaluation**
 - Focus has mainly been on structures rather than how these are implemented or outcomes achieved
 - Structures can’t always be ‘lifted and shifted’ between sectors
 - Without ‘You said: We did’ approach can be difficult to build trust
- **Gaps**
 - Cost of capital – uncertain role - public concerns around excess returns
 - Engagement has been ‘consumer’ focused – not ‘citizen’ focused
 - Limited cross-sector view on affordability of essential services
 - Little engagement on systemic issues / risks

Energy disruptors to *today's* approaches to public engagement in energy & water

1

Low carbon transition - renewables and embedded generation

- Two way flows and intermittency
- Decentralised and community approaches
- Stranded assets / death spiral of networks?

2

Resilience / security of supply

- Supply, demand-side & retail blurring
- New risks: cyber security; extreme and unpredictable weather; electricity dependency
- Multiple market actors – where should market obligations sit (eg supplier of last resort)?

3

Digitalisation

- Sensors on everything?
- Big data and predictive data
- End of supplier hubs

Societal disruptors to *today's* approaches to public engagement in energy & water

1

Data, digital services & new technologies – old boundaries breaking-down

- Passive to active customers
- Consumer / citizen 'divide' changing with local / community approaches
- How risks & rewards are shared. Radical re-think forced by data & tech

2

Rapid emergence of new voices & channels - social media / the young / devolved powers (including metro-mayors)

- Stakeholders – plural/fragmented. Challenge legitimacy of status quo
- Existing engagement and governance approaches need updating

3

Public sector restraint / austerity – companies expected to deliver more

- Expectation not clear on energy and water company role – for society, welfare-provision, environment
- Political risk as issues of fairness within & between generations come to fore
- Increasing interest in stakeholder economy / need to 'rethink' capitalism

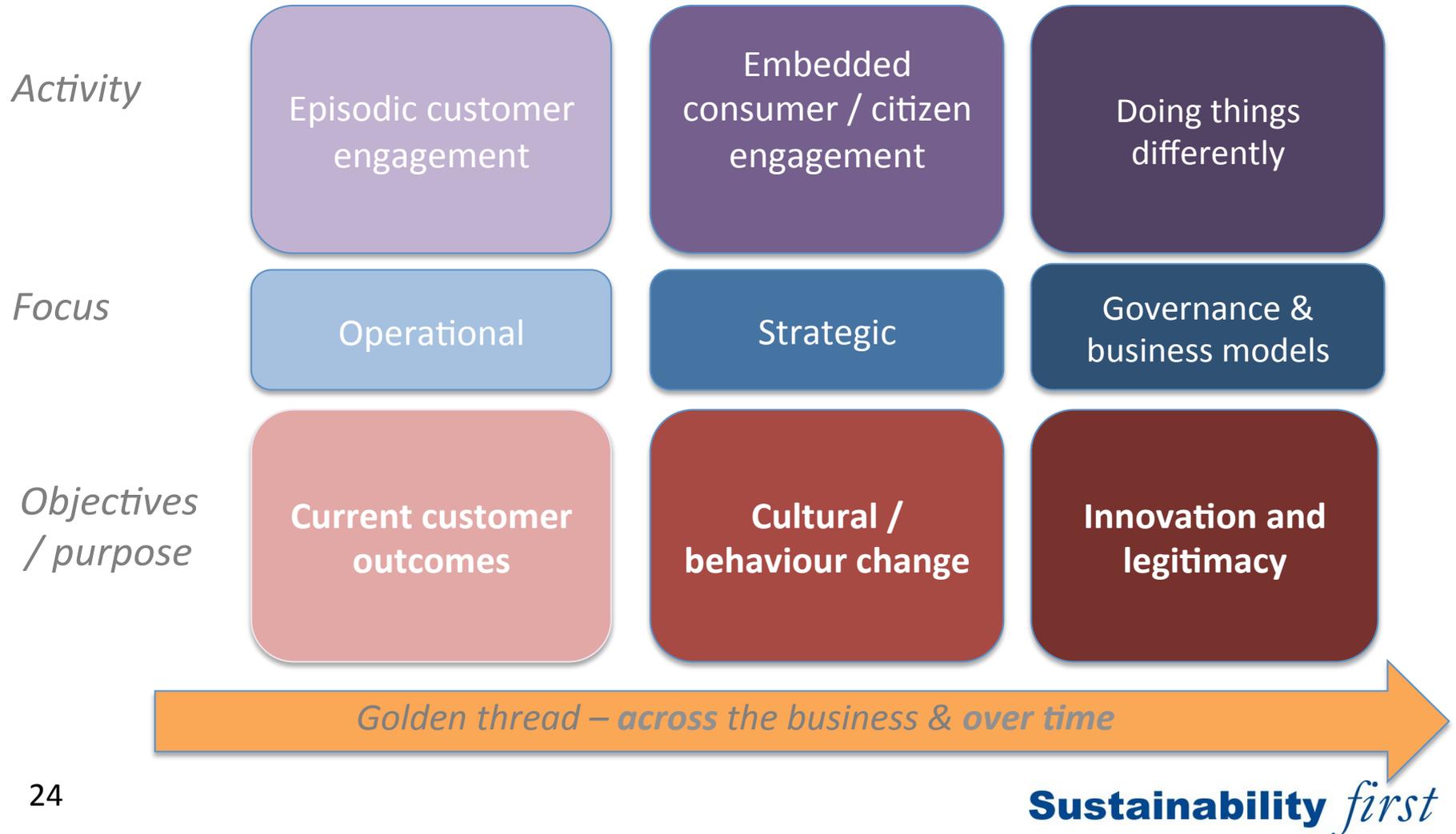
Engagement needs to evolve to keep in step with
the energy transition - & societal change





Transformative change is raising questions about the roles, rights and responsibilities of consumers, citizens, regulators, government and companies in regard to the energy system

In this disruptive environment, need a step-change in public engagement



Public engagement needs to shape board decisions

- To move beyond ‘window dressing’ public engagement needs to feed into board decision making
- This isn’t doing it just because the regulator asks or just having a ‘public interest’ – or employee - representative on the board
- It requires developing a far deeper understanding of the public interest and using this to shape governance in an on-going way
- Our **‘Board effectiveness checklist for meeting the needs of customers, future consumers and wider stakeholders’** summarises how this can be done in the energy and water sectors
- **In the UK**, we consider that energy companies need to apply this thinking to address **three public interest challenges**
- These are risks to the business and need to be actively managed as such. I’ll take each in turn

Delivering the public interest - challenge (i) Averting 'unacceptable' dividends and returns



What role can the board play to help move from this....



....to this, without pushing up the cost of capital?

Delivering the public interest - challenge (i)

Averting 'unacceptable' dividends and returns

Cause	Risk to public interest	Consequence	What to do - risk mitigations	Questions to consider ?
Company risk appetite out of step with public interest	Excess dividends and returns	Unfair distribution of risk and reward between customers & shareholders	Mechanisms to ensure user voice heard & acted on at TopCo level	How aligned is board risk appetite to public interest?
Complex ownership structures	Under-investment	Increased political risk leads to ad hoc policy and regulatory interventions	Ensure company (whether listed or not) complies with spirit of S172 of Companies Act	Public open to radical ideas - are you thinking creatively?
Strategy made at 'TopCo'		Rising bills and consumer backlash		Does TopCo give consideration to ethical / fair behaviour?
Insular regulatory world		Creaking assets		Consumer Panel sees key papers going to board?

Delivering the public interest - challenge (i)

Averting 'unacceptable' dividends and returns

- Does the TopCo hear and act on the user and wider stakeholder voice?
- Is board risk appetite *appropriately* aligned with the long-term public interest?
- Does board comply with the *spirit* of Section 172 of the UK Companies Act (long-term impact of decisions, regard to impact of these on the environment & community, employees etc)?

Delivering the public interest - challenge (ii)

Building better regulator / company relationships



What role can the board play to help move from this....

...to this, without political backlash and fear of regulatory capture?

Delivering the public interest - challenge (ii)

Building better regulator / company relationships

Cause	Risk to public interest	Consequence	What to do - risk mitigations	Questions to consider ?
Complex regulatory landscape & group structures	Relationships – unconstructive / polarised	Lack of ownership of the future	Shared future narrative to be developed by companies with stakeholders	What is company board doing to reclaim strategy?
Regulator as policeman		Undue compliance approach by companies	Commit to continually improve relationships	Are there safe spaces for dialogue?
Undue focus on process not long-term outcomes		Company inertia - & risk aversion	Set right tone <i>throughout</i> organisation	Are there feedback loops between different parts of the system?
How to regulate for uncertain future		Limited innovation	Stakeholder engagement set in long-term context	What relationships needed to be 'respected citizen'?
		Potential under / over investment		
		'Shadow boxing' between companies & regulators		

Delivering the public interest - challenge (ii)

Building better regulator / company relationships

- What is the board doing to move away from undue focus on compliance and reclaim strategy – for itself & the sector?
- Are there ‘safe spaces’ for board / regulatory dialogue?
- What relationships are needed to be ‘respected citizens’?

Delivering the public interest - challenge (iii)

The important role of the Non Executive Director



What role can the board play to move from this (wool over their eyes)



.... to this, while retaining sight of long-term public interest outcomes ?

Delivering the public interest - challenge (iii)

The important role of the Non Executive Director

Cause	Risk to the public interest	Consequence	What to do - risk mitigations	Questions to consider ?
<p>Failure to explain. Leads to nervous politicians & press</p>	<p>Poor relationships around the board table – and / or with government</p>	<p>Failures may go unreported until too late</p>	<p>Informal space for Board interactions & to hear from stakeholders - <i>together</i></p>	<p>How does board have a strategic focus on the public interest?</p>
<p>Exec / Non Exec - information asymmetry</p>		<p>Focus on compliance. Board don't know if Exec gives full picture.</p>		<p>Board diversity (including in <i>thinking</i>)</p>
<p>Board agenda – poor balance of strategy and detail</p>		<p>Lack of sector-wide leadership</p>	<p>Succession planning. Know reasons for success & failure</p>	<p>How does board set tone from top / ensure public interest values percolate down?</p>
<p>Engineers and economists - technical disciplines</p>				<p>How does board address unpalatable risks e.g. public ownership, difficult relationships?</p>

Delivering the public interest - challenge (iii)

The important role of the Non Executive Director

- Does the board have the right skills mix and diversity (including cognitive diversity) for the public interest?
- Are there informal spaces for board interactions and to hear from stakeholders *together*?
- How does the board set the tone from the top to ensure that public interest values percolate down and behaviours are aligned with company purpose?

Conclusion

- Under intense political pressure, energy companies in the UK are starting to listen to their customers and work with them to deliver the energy transition
- There is still a long way to go
- Companies have a major opportunity to seize the day and get better at engaging with their customers, consumers and wider stakeholders
- If they don't do this, they will be left behind in the new smart world of active demand and increasing calls for more participatory decision making
- In the absence of a more collaborative approach they may even face failure
- Embedding public engagement in the business is crucial to manage risks in this area
- Australia can learn from the UK example but 'lift and shift' approaches to engagement are unlikely to work
- Engagement needs to have a clear purpose and reflect the context within which it is being introduced
- Boards need to lead and engagement needs to go through the organisation – like a golden thread

Putting consumers and citizens front and center of decision making – working together for change



Contact details

Sharon Darcy at sharon.darcy@sustainabilityfirst.org.uk

Registered Charity Number: 3987720

See our publications at

www.sustainabilityfirst.org.uk

Follow us on Twitter

@SustainFirst