





Fair for the Future:

Framing a ‘Sustainable Licence to Operate’ for the water and energy sectors

Strawman: Framework and issues
October 2018

Sustainability *first*

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This report has been written and researched by Sharon Darcy and Robert Hammond with support from Judith Ward and Associates at Sustainability First.

For further information about the Fair for the Future project or to share comments on this paper, please contact sharon.darcy@sustainabilityfirst.org.uk



Preface

About Sustainability First

Sustainability First is a think tank that promotes practical, sustainable solutions to improve environmental, economic and social well-being. We are a registered charity that primarily works in the electricity, gas, water and waste sectors.

The Fair for the Future project

Sustainability First's new major Fair for the Future project aims to enable electricity, gas and water companies, policy makers and regulators to better address the politics of fairness and the environment – in the process getting companies to demonstrate corporate leadership by 'doing the right thing.' A key part of the project is developing a 'Sustainable Licence to Operate'.

The purpose of this strawman

This strawman 'Sustainable Licence to Operate' Framework and Issues paper is intended to start a discussion on the approaches proposed and to 'crowd source' possible solutions to any short-comings. It is being circulated widely to stimulate debate. The strawman will be tested over the next eighteen months in a series of workshops with key external stakeholders and against deep dive case studies from other sectors and energy and water providers in other jurisdictions.

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Independence: It should be noted that editorial responsibility for this strawman rests solely with Sustainability First.

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Registered company number: **3987720**
Registered charity number: **1078994**

Address: **c/o IEEP, 3rd Floor, 11 Belgrave Road, London, SW1V 1RB**

www **sustainabilityfirst.org.uk**

@SustainFirst

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Executive summary

The energy and water sectors are at a major inflexion point in terms of both fairness and the environment. The detail may differ between energy and water, and within energy, but four major challenges dominate: profound change in technology, environment/climate and society; increasing complexity and inter-dependency in the wider 'systems' in which energy and water companies operate; a pressing need for people-centred change in a social media world; and the need as essential service providers for companies to navigate a world where the role of the state, policy and regulatory frameworks are in flux.

Many solutions are being canvassed to navigate these difficult waters, including changed ownership models, reform of corporate governance, new thinking on competition and collaboration and the reshaping of institutional governance and policy frameworks. These approaches raise fundamental questions that go beyond economics into politics – and even morality. But to focus on just one solution-area or to take a purely partisan view will not be sufficient given the nature of the challenges faced. And awaiting clarity from policy makers and regulators in the current political environment may lose precious time - and anyway not 'solve' the underlying issues that have been raised.

Most companies are already doing much constructive work to address our many societal and environmental challenges. However, this can sometimes be in silos within a business or come across as a reaction to policy and regulatory pressure – 'compliance with the legal minimum' nested within regulatory or Corporate Social Responsibility functions - rather than part of a positive organisation-wide strategy that demonstrates corporate leadership.

Given the profound changes faced, forward looking companies need to do more to get on the front foot if they are to retain a 'Sustainable Licence to Operate' with their stakeholders. Engaging with all stakeholders to better understand, meet and demonstrate what the company is doing to address their expectations is likely to be crucial to this



process and vital if it is to be seen as legitimate. This includes not only customers, employees and investors but also the wider stakeholders that the company may want and need to partner with to meet social and environmental goals. Adopting an integrated approach to change, so that an understanding of the company's role in terms of society and the environment drives activity across the business and is embedded in 'business as usual' decision-making, is key.

The Fair for the Future project builds on Sustainability First's major New Energy and Water Public Interest Network ('New-Pin') project. Through a three-year deliberative engagement process with key stakeholders, New-Pin helped to define the long-term public interest for the energy and water sectors. On the back of this work, Sustainability First's new Fair for the Future project proposes that **a 'Sustainable Licence to Operate' in the sectors is built on four pillars**. These are interconnected. And, because the pillars are geared to actions which can address major challenges, they won't always be 'got right' first time. Agility and iteration will be necessary as will adapting this thinking to each individual company's requirements and local/regional/national environment.

Much will depend on whether water, electricity or gas, where the company sits in the value chain, whether a new entrant or incumbent etc.

The first pillar we propose for a 'Sustainable Licence to Operate' is to review and develop the company's **public purpose, philosophy and public service values.** This requires the company reassuring itself that it has got the 'basics' right and is meeting its statutory and licence conditions *and then* asking itself how in a disrupted world it may need to re-interpret its licence obligations in terms of fairness and the environment. Context is key here. Stakeholders may rightly expect a utility company – providing essential services/public goods that are universally used - to have a strong and evolving 'public' purpose if it continues to have significant market power, high and long-term investment requirements, is reliant on a significant and growing role for people (eg through the demand side) and if it is firmly linked into wider and ever more complex technical, environmental and social systems (particularly when these require stewardship of precious natural resources).

The drivers that help shape purpose and values in a company include ownership models, types of investors and corporate structures. Blanket generalisations about these can easily become misleading. Although these factors can clearly shape how companies' approach and prioritise social and environmental issues, it is important to note that there are examples of 'good' and 'bad' organisations in privately owned electricity, gas and water companies just as there are in public sector bodies and even charities. But without a 'Sustainable Licence to Operate,' such generalisations can be hard to overturn.

Strong corporate governance and a culture that embeds purpose and values in any company are important - whoever the owners may be – and are more than usually important we argue in utilities. Each company needs to develop and 'own' their values but where the company has a strong public purpose, stakeholders may expect these to cover public service values such as accountability, respect and integrity, openness and honesty, objectivity and collaboration and leadership (to deliver public purpose). The strawman suggests that companies need to be able to articulate where they stand in this area through a '*Statement of company purpose, philosophy and values.'*

The second pillar for developing a 'Sustainable Licence to Operate' that we propose is **making the best use of the company's different types of 'capital'** (natural, manufactured, intellectual, social and relationship, human, financial and crucially also data) through appropriate competition and collaboration, within the confines of regulatory and competition law**.** Both approaches to service delivery have different benefits and shortcomings. Until recently, collaborative approaches have received less attention than competitive approaches (particularly in energy). This is starting to change as digitisation and AI reshape the public sphere. Ecological instability has the potential to lead to even greater change in this area. Social, integrated and circular business models are increasingly seen as central to delivering deep-seated change. Policy and regulation frameworks are clearly also influential here: where these focus on short-term efficiency within existing boundaries, it may be more difficult for companies to deliver wider public purpose goals and 'systems' value. The strawman proposes a '*Decision making framework for thinking about competition and collaboration to make best use of capital.'*

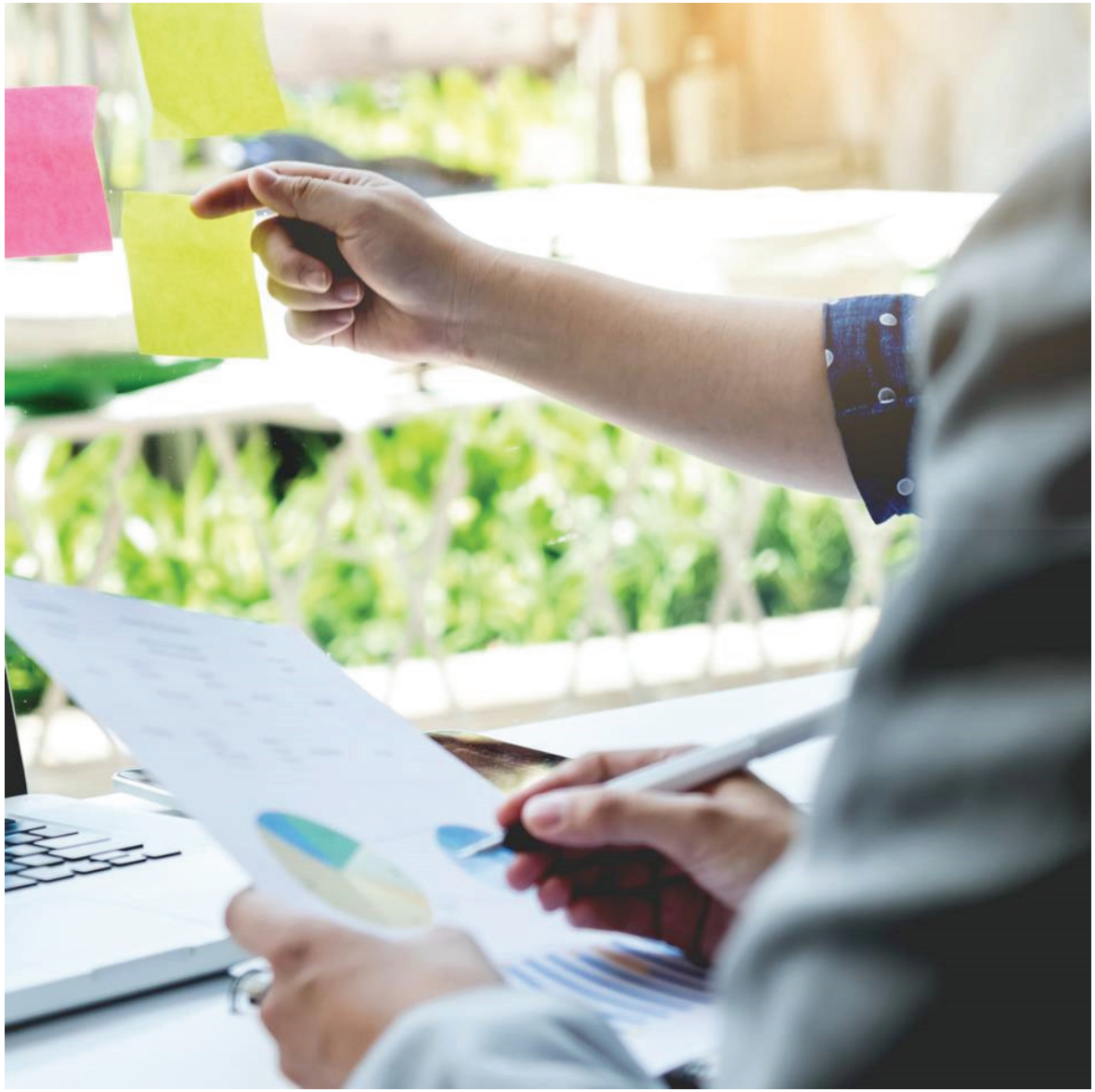
Roles and responsibilities represent the third pillar proposed to develop a 'Sustainable Licence to Operate.' Roles and responsibilities have significant implications for what is considered to be fair and ensuring vital intergenerational/ long-term aspects of fairness (including environmental interests) are given appropriate weight. There are likely to be varying perspectives here, but fairness has different dimensions: opportunities; voice/having a 'say' (particularly for key stakeholders such as the natural world where this voice may often be overlooked); process/behaviours; outcomes; deals; and explanations. Expectations around fairness are changing in terms of: state/business relationships; a desire for greater control/democratisation; a shift in focus from vulnerability alone to bespoke needs of every customer (including those that may be unable or unwilling to engage in markets); a significant shift to service-oriented business; and cross-sector dimensions of fairness. A corresponding step-change must therefore follow in how all stakeholders are engaged in matters of fairness. The strawman explores the idea of creating '*Compacts for fairness*.'

The final pillar in developing a 'Sustainable Licence to Operate' that we propose is for a company to develop a **strategy and accompanying narrative** which conveys an honest (and hopeful) future road-map for itself and crucially also for the sector. This needs to move beyond reporting data that can be silo based and derived from an internal assessment of past performance to a narrative which is based on metrics and outcomes that are relevant to the intended audience and includes leading indicators that have been independently verified and 'triangulated' to provide a coherent/integrated view of the company, its culture and where it is going – and are comparable between companies. Companies are making progress in this area, but further work is needed to ensure that these narratives also demonstrate the contribution that the company has made to the sector and wider systems (social, environmental, technological etc) in which it works.

Companies can't make all these changes alone. And company action in these areas *does not* take away the need for policy and regulatory frameworks to be redrawn. But corporate leadership is key to successfully drive the shape of emerging policy and to ensure that new regulatory arrangements focus on future social and environmental needs rather than current, or past, pre-occupations.

Beyond the next election - and any changes in ownership, corporate/institutional governance, policy and regulatory frameworks and business models that this may bring - companies will still need to navigate through the seismic changes that are outlined in this paper. The Fair for the Future project provides a framework to do this.





Outline of this paper

This strawman Framework and Issues paper begins with a brief overview of Sustainability First's Fair for the Future project, explaining how this is made up of two workstreams: one developing the 'Sustainable Licence to Operate;' and the other mapping political and regulatory uncertainty and risk regarding fairness and the environment in the energy and water sectors.

The main section of the paper begins with an examination of the watershed that the electricity, gas and water sectors in GB are currently facing. It then explains how the Fair for the Future project is building out on the ground-breaking work that Sustainability First recently undertook with its New Energy and Water Public Interest Network ('New-Pin') project. It then sets out some key working definitions for the project.

The paper moves on to assess why a 'Sustainable Licence to Operate' is needed by GB electricity, gas and water companies at the moment and explores the key challenges faced. It explains why each of these has a particular significance in the electricity, gas and water sectors. It then summarises the four pillars that could make up a 'Sustainable Licence to Operate' before examining how these pillars are inter-connected and need to be approached in an iterative and flexible way.

The Appendices to the paper provide some more initial supplementary detail on each of the four pillars that could make up a 'Sustainable Licence to Operate.' These are very much a work in progress and will be tested and refined over the next eighteen months.

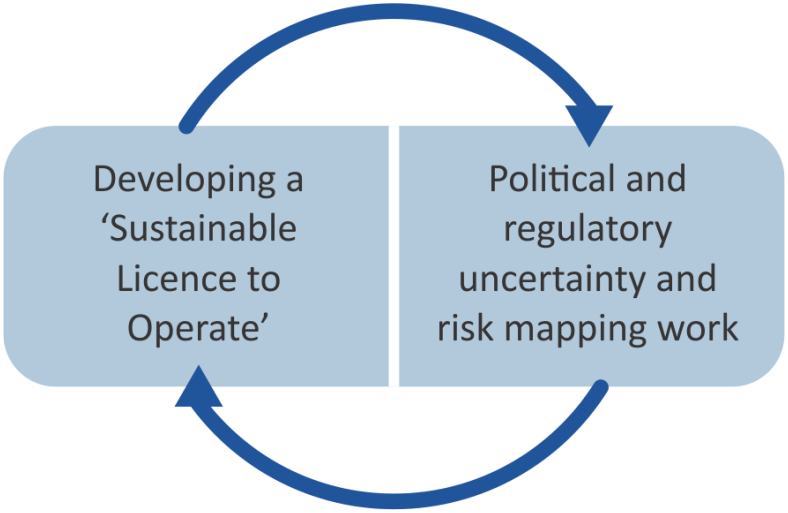
What is the Fair for the Future project?

Sustainability First's new major Fair for the Future project aims to enable energy (retail and network, gas and electricity)[1] and water (household retail and wholesale) companies, policy makers and regulators to better address the politics of fairness and the environment – in the process getting companies to demonstrate corporate leadership by 'doing the right thing.' Its **objectives** are to:

- Identify a common framework of good practice/standards for doing this – that companies can turn into actions that go 'above and beyond' legal compliance and basic Corporate Social Responsibility – that sets the ambition companies need to measure up to in the future – rather than being based on what is achievable now;
- Help companies more confidently embrace disruption so that they are better able to anticipate, influence and proactively cope with change – including in public opinion and environmental/climate issues – so that they are not 'buffeted' around by events;
- Provide a radical step change at both board and operational level in company approaches to engagement, governance and business models that are relevant and meaningful in an increasingly complex world where boundaries between sectors and between consumers, citizens and employees are blurring and the nature of communications is being profoundly reshaped; and
- By focusing on long-term public interest outcomes, build a bridge between polarised ideological debates without being partisan.

The project started in May 2018 and will run for three years. The project has two workstreams which are illustrated in Figure 1 below. The workstreams are interconnected and will influence each other but are currently being run in parallel.

Figure 1: The two workstreams in the Fair for the Future project



This strawman is the first output from the Fair for the Future **'Sustainable Licence to Operate'** workstream. It provides an early high-level framework and set of issues for companies to use to begin to think about how they could develop a 'Sustainable Licence to Operate' with their own stakeholders for their own business. The paper is intended to generate a discussion and crowd source ideas about solutions to deal with any short-comings. It is being circulated widely to stimulate debate.

This is just the beginning. Over the next 18 months, we will be testing the strawman 'Sustainable Licence to Operate' framework with key stakeholder groups and against good practice from other sectors and from energy and water providers in other jurisdictions. At this stage, we will carry out 'deep dives' into relevant case study organisations.

We will invite a wide range of key stakeholders to a series of workshops where we will explore the issues raised in this paper and the case studies, asking how relevant they are to the GB water and energy context. In the process, we will 'kick the tyres' on the 'Sustainable Licence to Operate' proposals. **If you would like to be involved in these workshops, please let us know.** Following the workshops, we will test the emerging 'Sustainable Licence to Operate' thinking against some possible scenarios that the energy and water sectors may face to assess how the framework might be used in practice. At each stage of this process, we will be refining our thinking and revising our proposals.

The 'Sustainable Licence to Operate' will seek to achieve the following **outputs**:

- Consensus on a common framework of good practice and standards for addressing the politics of fairness and the environment that is less 'charged' - and to encourage companies to put this into action.

- Companies to take the initiative to develop a strategy and accompanying narrative for themselves and crucially also the sectors to build trust with their consumers and wider stakeholders. The evidence base of what has been done as a result of the 'Sustainable Licence to Operate' will help demonstrate how this narrative can be turned into long-term public interest outcomes for consumers and wider stakeholders.

The Fair for the Future **political and regulatory uncertainty/risk mapping workstream** aims to ensure a more comprehensive and coherent view of political and regulatory uncertainty and risk for the water and energy sectors in respect to fairness and the environment – ensuring that nothing is 'left out.' It is seeking to understand more how the boundaries of political and regulatory uncertainty and risk are changing for these sectors and may interact in the future and 'open up' current debates about fairness and the environment to new / more voices – so that these become a genuine reflection of wider societal sentiment / public mood.

In this way, it will help develop a common language for dealing with these risks that all sides can use when considering what a 'Sustainable Licence to Operate' might look like in the electricity, gas and water sectors and when it could be used.

An **early output** from this workstream is available on the Sustainability First website.

At the end of the project we will summarise our conclusions from both the Fair for the Future project workstreams in a:

- '**How to Guide' for developing a 'Sustainable Licence to Operate;'** and
- Report on the **implications that the wider Fair for the Future project conclusions may have for future policy and regulatory frameworks.**

Testing the 'Sustainable Licence to Operate' strawman

Over the next 18 months we will be testing the strawman with external stakeholders in the following workshops:

- **December 2018** - Public purpose, philosophy and public service values
- **March 2019** - Making best use of capital
- **June 2019** - Roles and responsibilities
- **November 2019** – Strategy and narratives

Framing a 'Sustainable Licence to Operate' for the water and energy sectors

Introduction

This decade has become a watershed for fairness and the environment across the economy. A perceived failure to deal with the root causes of the 2008 financial crisis and the European Referendum vote have led to increasing polarisation and fragmentation in society. This has been compounded by high-profile corporate failures such as Carillion and some rail franchises, leading to fundamental questions amongst policy makers, regulators, companies, investors and civil society about how to ensure that businesses work in the public interest.

The electricity, gas and water sectors, as providers of essential services through private companies operating in often monopolistic / imperfect markets, are in many ways in the frontline of these debates. Many people – and politicians - are now challenging how far most energy and water companies 'work for them,' pointing out that competition and market-led approaches, the great hope for delivering customer focused services, have struggled to deliver the necessary or desired outcomes.

What constitutes 'fairness' in the sectors is far from settled (particularly in energy where prices are higher) and is likely to remain so as incomes for many remain static or fall and new concerns around wealth inequalities that advantage older people compared to the younger generation are raised. Climate change and environmental pressures that raise questions of inter-generational fairness and environmental sustainability have been brought into sharp relief with recent extreme weather across much of the globe. And the recent step change in public opinion on plastics is a major example of industries can be disrupted very quickly.

In energy and water, the conduct of some companies has been called into question (eg price differentials in energy where customers have been penalised for their loyalty, [2] quality of service outcomes in energy and water, [3] poor complaint handling in gas and water[4] and water pollution incidents being treated as a 'business expense').[5] These factors have eroded confidence at the same time that pay and returns have eclipsed even more positive experiences. Companies with good service have been tarred with the same brush as those that have let standards fall.

With trust at a low ebb, and decision makers often seeming remote and out of touch, the role of the state and its relations with the corporate sector are being assessed across the political spectrum. This is at its most intense when, as is the case in energy and water, the services being delivered are widely viewed as public goods. Nationalisation for monopoly infrastructure providers is once again on the cards. And even the Government itself has been frustrated at its arms-length role, spilling into ad-hoc interventions such as price caps, which have challenged the independent regulatory framework.

Sustainability First's Fair for the Future project was set up to try and chart a course through some of these complex, inter-related and difficult issues. Almost thirty years after energy and water privatisation, and with limited collective memory of the original arguments for private ownership, competition and regulation (and recognition that some water only companies have never been in public ownership), it is appropriate to ask how current arrangements for empowering and protecting consumers – and citizens and the environment – in these sectors could be improved.

Companies that want to 'do the right thing' have often found it difficult to know what to do and where to go. Waiting for a lead from policy makers and regulators has,

in some cases, been like looking at a 'whirlpool.' Brexit is clearly making this problem more acute. The increasing pace of technological change, with distributed energy, AI and blockchain, and the accelerating impacts of climate/environmental change, are accentuating these challenges. At the same time, most know that just sticking to compliance is unlikely to prepare them for the transformational change that may be needed. Adopting a 'wait and see' approach may lose valuable time, foreclose future options / push up costs and damage reputations.

Developing a 'Sustainable Licence to Operate,' in conjunction with their stakeholders, is one way for companies to get on the front foot and in the process demonstrate positive corporate leadership. **On its own, it will not solve all of the many and varied challenges that an electricity, gas or water company, and their stakeholders, face.** Policy and regulatory frameworks will also have to change to prepare for the future. However, where proactive companies start leading by example, this should help clarify when and how institutional governance, policy and regulation also needs to be reshaped.

Building on Sustainability First's New Energy and Water Public Interest Network ('New-Pin') project

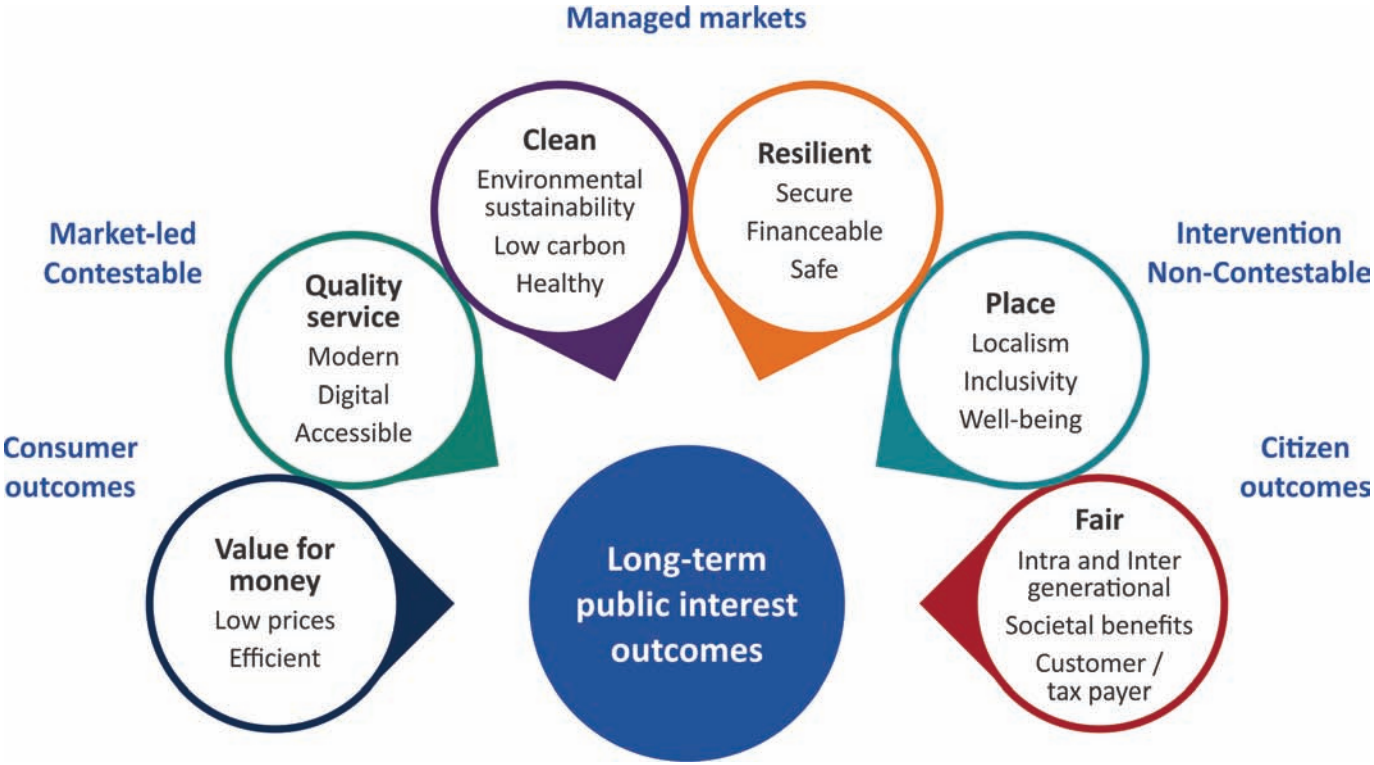
The Fair for the Future project builds out from the findings of Sustainability First's ground breaking New-Pin project.[6] This major three-year deliberative engagement project, which concluded in February 2018, brought together public interest groups (consumer, citizen and environmental) with government representatives (BEIS, Defra, the National Infrastructure Commission), regulators (Ofgem, Ofwat and the Environment Agency), energy and water companies and academics to identify and develop a stronger voice for the long-term public interest in the energy and water sectors. New-Pin developed new insights, including the role of market-led approaches and interventions in delivering long-term public interest outcomes, and produced key tools for change, including a check-list to assess how effective boards are in meeting the needs of current customers, future consumers and wider stakeholders. This strawman draws heavily on New-Pin research, definitions/terminology and wider findings.

Key working definitions for this strawman

The Fair for the Future project has chosen to use the term '**Sustainable Licence to Operate'** to: indicate the importance of energy/water companies taking a long-term public interest perspective (in both social and environmental terms); and recognise that companies in these sectors need to continuously work with stakeholders to build trusted relationships. For this strawman, it is defined as a company's '*On-going endorsement to operate within society and the energy/water system to deliver long-term public interest outcomes*.'

The strawman uses the following definition of the **long-term public interest in the energy and water sectors** '*The aggregate well-being of the general public, both short and long-term. It comprises the combined interests of consumers, citizens, the environment, employees and investors, for both today and tomorrow.*' As illustrated in Figure 2, New-Pin concluded that the 'desired' long-term public interest outcomes that are part of this consist of: 'customer' outcomes (value for money, quality service and clean/sustainable services); and 'citizen' outcomes (resilience, place-based well-being and fairness). The latter outcomes clearly exhibit strong elements of what are traditionally seen as social and environmental externalities and often need to be delivered through managed markets and interventions/non-contestable approaches.

Figure 2: Sustainability First's New-Pin long-term public interest 'dashboard'



Source: Sustainability First, Looking to the long-term: Hearing the public interest voice in energy and water, February 2018

Fairness can be defined as '*The impartial treatment or behaviour towards people and different stakeholder groups (including the environment) without favouritism or discrimination or in a way that is right or reasonable*.' It is a multi-dimensional and relational concept, as well as being a political and moral one. Fairness outcomes are important *within* generations (between: socio-demographic and customer groups [including can't pay/won't pay in water]; geographically; bill payers / consumers, tax payers, providers of capital; employees [the Living Wage etc]/management; and recognizing the needs of customers in vulnerable circumstances) and *between* generations. The latter includes the need to preserve the integrity of the eco-system. Outcomes, processes/behaviours, voice, deals, opportunities (within and between generations) and explanations are all important dimensions of fairness.

Long-term public interest outcomes around the **environment** include: clean; sustainable; low carbon; and healthy (for consumers and for the environment itself). Environmental needs include biodiversity, habitat protection, eco-system integrity and working within systems limits. Meeting Climate Change Act commitments, the advice from the Committee on Climate Change and commitments highlighted in the 25 Year Environment Plan will be necessary to deliver these outcomes. The IPCC's October 2018 report on global warming will also need to be taken into account.[7]

The **Glossary** at the end of this paper provides a summary of some of the key terms and 'working definitions' used in the strawman. Clear definitions are central to a 'common language' in what can be a controversial area and where different disciplines may have different understandings of some terms.

Background to the concept of a 'Sustainable Licence to Operate'

'Social Licence to Operate' - used in sectors such as mining where companies need on-going approval to operate within a community. To gain this 'permission' they firstly need legitimacy before getting the credibility that will help build trust

'Social contract' - dating back to Thomas Hobbes, John Locke and Jean-Jacques Rousseau, this is more political/philosophical. It is an agreement among individuals to secure mutual welfare and regulate relations among members

'Social compacts' - involve agreeing 'accountability bargains' between companies and citizens. Used in developing countries by IMF, World Bank etc and NGOs that may become 'de-facto regulators' (eg Marine Stewardship Council)

Source: Sustainability First

What is the problem in water and energy that a 'Sustainable Licence to Operate' seeks to address?

Electricity, gas and water companies are already at a water shed moment. Looking ahead, their operating environment is set to become tougher still. Being able to anticipate and navigate through the following **four major challenges** will be vital if companies are to survive and thrive. Clearly many of these challenges apply to all large businesses. This section of the strawman seeks to explain their particular significance in the electricity, gas and water sectors.

Given the depth of these four major challenges, pure economic levers cannot suffice. An economic analysis based on an assessment of visible and static monopoly harm and 'market failure' often determined by old world boundaries does not offer the full range of solutions and actions needed in the current environment. Disciplines of political, social and environmental science, psychology and organisational development each also have a part to play. Developing a multi-disciplinary approach that gives due consideration to social and environmental outcomes is difficult. But as the following challenges are significant, long-term and unlikely to 'go away' (particularly environment/climate change), getting this 'right' is important.

Challenge 1:

Exponential change driven by technological, environment/climate and societal disruption[8]

This will present opportunities but also risks to the delivery of public interest outcomes and raises questions of how best to balance different interests and the distributional impacts of change in a way that is 'fair' for customers, future consumers and wider stakeholders (including the environment). Some of the different challenges in terms of fairness that these disruptions raise are illustrated in Table 1. The relative importance of these different changes may vary between sectors (eg technological change is currently much more significant in energy than water). Many of the disruptions have potentially both positive and negative aspects for fairness and the environment. However, their combined impacts can make these impacts difficult to predict.

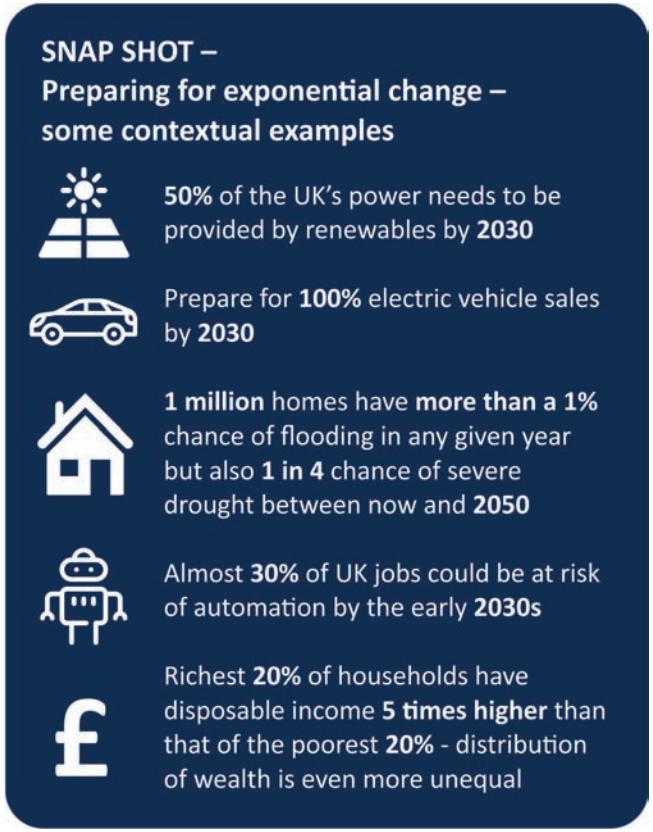
All these challenges become particularly important when seen in the context of the need to meet the UN Sustainable Development Goals (SDGs)[9] by 2030. In order to meet these goals, companies may need to embrace exponential thinking; the shift from incremental innovation (doing the same things better) to transformational innovation (doing different things).[10]

Table 1: *Some* of the possible distributional/'fairness' impacts of technological, environment/climate and societal disruption in the energy and water sectors

Type of disruption		
Technological	**Environment/climate**	**Societal**
• Sensor tech and data can reduce leaks etc & ↑ energy/water saving – fairer for environment • Predictive analytics ↑ efficiency but may disadvantage certain groups • Digitisation enables ↑ personalisation & cost reflectivity. Cross-subsidies unwind • Differential pricing. Impacts may be cumulative across utilities & services • ↑ tariff complexity possible • New 'challenger' businesses may / may not have /deliver social/ enviro obligations • Decentralised local / community approaches possible • Stranded assets & legacy systems – who pays? • Early adopters of new tech benefit at the expense of others • Public expect more responsive services & greater say • ↑electricity dependency • Longer/more complex supply chains possible, diminishing role for retail intermediaries	• ↑ extreme and unpredictable weather • Investing ahead of need to keep future options open & manage future costs • Costs of adaptation/ mitigation may ↑ bills & affordability pressures • ↑ shocks > impact people in vulnerable situations. Impacts may be cumulative • > role / contribution required from demand side. People on low incomes may struggle to afford smart kit • Peak/seasonal tariffs may ↑ affordability pressures at certain times for those on low incomes • Renewables/low carbon approaches create local opportunities (& costs) • Decarbonisation of transport creates opportunities for energy • Plastics/micro-plastics & other new sources pollution not yet addressed by existing laws/regulations • Air pollution impacts different communities in different ways • Biodiversity/habitat loss - indirect distributional impacts & on certain groups (eg farmers, fishermen)	• ↑ inequalities between generations (especially wealth, land etc) • ↑ insecurity ('precariat') • Social media – can disrupt considered & evidence-based policy formulation • Aging society – live longer with more disabilities – need warm homes & hot water • Crisis in adult social care putting pressure on other services • Dynamic vulnerability – social tariffs & price caps • Changing tenures – generation rent - ↑ difficulty of installing energy / water saving measures • Distrust of 'the system' • ↑social fragmentation & polarisation of views • Politics/'establishment' seen as ineffective • Desire to 'take back control' • 'Capitalism in crisis' – post 2008 still asking how business needs to change • Devolution & democratisation - ↑ local, regional & national difference • ↑social conscience re supply chains & corporate ethics – not necessarily reflected in behaviour

Source: Sustainability First

Of course, these major disruptors are in many respects impacting different companies right across the economy. What makes energy and water companies different in this respect is that they provide essential services that are **universally used and are core to social, economic and environmental wellbeing** - and therefore need to be delivered on a basis that is generally seen as 'fair.' Thus, the system needs to ensure that those who are not able or have difficulty in engaging with services (eg people in vulnerable circumstances), those who do not wish to engage actively with the system (eg 'sticky' / loyal energy retail customers) and those that don't have a 'voice' to be able to engage (future generations, nature etc) are treated in a way that is not unduly discriminatory compared with those who do engage actively. This applies just as much when the service fails to deliver in emergencies as in more normal times. Clearly different companies within the electricity, gas and water systems will have different responsibilities with respect to these needs, but none can escape the need to address them.



Source: National Infrastructure Commission, National Infrastructure Assessment, July 2018; PWC, Will robots steal our jobs? March 2017; Which? Income and wealth inequality, 2018

Challenge 2:

Increasingly complex and inter-dependent systems

There is a growing recognition that companies across the economy are part of complex and interdependent systems that can be subject to systemic risks. These points are leading many to call for a new '**systems based'** approach to how companies do business. There are numerous definitions of 'systems' in this context. Greater clarity is needed to avoid talking at cross-purposes. The following are some of the most relevant:

- Environment: Ecosystems include bio-diversity/habitats, air/water quality, noise pollution etc;
- Society: Social systems and social infrastructure;
- Technology: 'Ecosystems' here normally refer to the Internet of Things; and
- Business: 'Ecosystems' are considered to be dynamic and 'co-evolving' networks of interlinked companies and supply chains where new types of hybrid organisations are evolving (social enterprises etc).

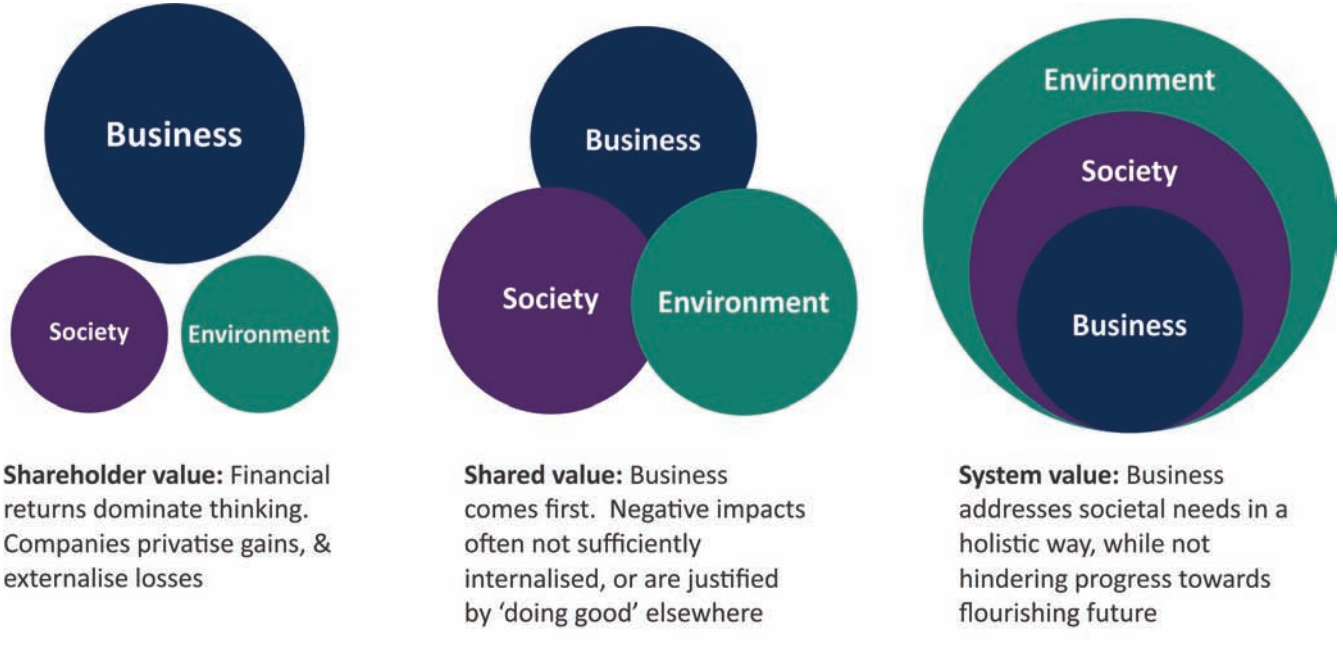
In energy and water there are added layers of complexity as these sectors are also part of their own systems. In energy, there is an increasing focus on looking for approaches that meet the needs of the **whole energy system**, from production to the end consumer. With the growth of prosumers, embedded generation, storage and heat – plus the blurring lines between transport and energy (electric vehicles, hydrogen buses etc) - system

flows are becoming more complex and two way. The **water cycle** is clearly even more complicated and circular, extending from catchment management via the consumer to waste water and ultimately re-use. **Energy/water nexus** issues (where one sector needs to use the services of the other to deliver its own services) add to this complex picture.

As all these networks and webs of activity extend, and the boundaries between different markets start to blur/break down, we are at an inflexion point where across the economy **social and environmental 'negative externalities'** to business are **being reassessed and frequently reclassified** as no longer being external to business but being key to shaping future business strategies.

New economic thinking is trying to put more shape around **public value** in this space and how this can be created through 'constructive flows' in the public economy[11] for all types of business. Many commentators now consider that delivering positive value requires a shift from conventional thinking around shareholder and enterprise value, through to shared value to **systems value**. This is illustrated in Figure 3.

Figure 3: Rethinking value creation through a systems lens



Source: Future-Fit, Business Benchmark, February 2018

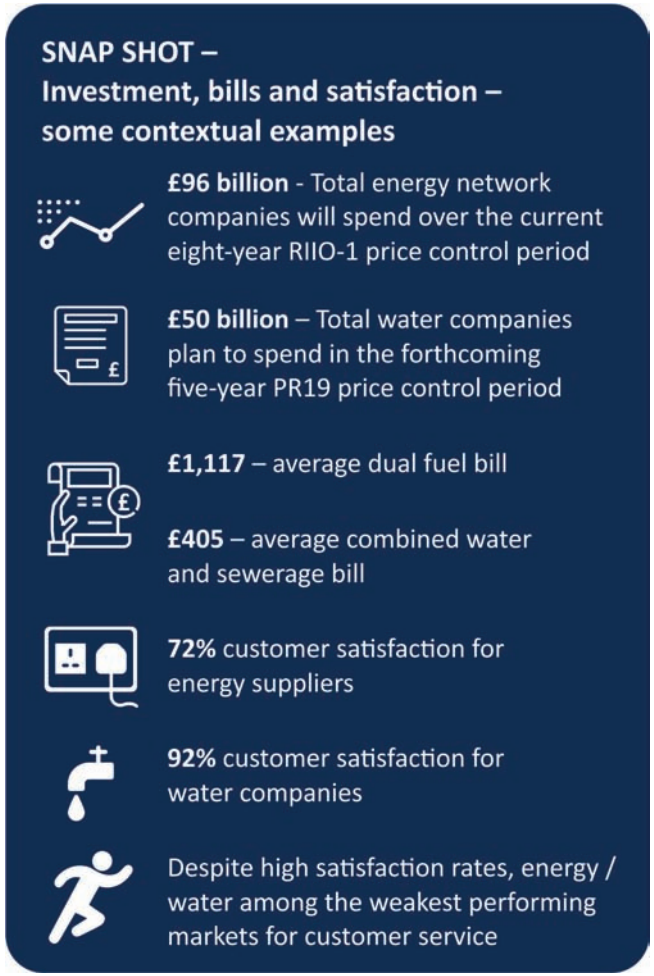
Challenge 3:

Achieving people-centred change in a social media world

The immediate 24/7, 365 response times now required from business leaders – and politicians - can make decision making unduly reactive, short-term and part-informed. Support for a company can be eroded in a tweet and challengers (and mavericks) can unpick reputations in the blink of an eye. Building legitimacy and trust in an era of fake news and 'calling-out' is difficult at the best of times. Doing this against a febrile back-drop where 'the establishment' in all its forms is under attack makes this more challenging. At the same time, however, there is a real opportunity to use social media/new platforms to positively build relationships with a much wider range of stakeholders and to take a more inclusive and people centred approach to service delivery. This can be more powerful when there are strong third-party endorsers, or these can be created.

This has a particular importance for energy and water as **consumers are footing the bill** for significant **future investments** for services over which they have no or very limited choice (in water and energy networks) at the same time as being increasingly required to play a more **active role**, whether this is through demand reduction, demand side response, becoming prosumers, community schemes, purchasing smart appliances or in response to increasing shocks (natural and cyber). As people, both individually and also as part of groups and communities, take on more responsibilities for energy and water service delivery, they will rightly expect a greater say.

Social media provides a platform to do this. It also enables new **identities** to emerge and existing identities to be reshaped. This can be important for 'place based' companies such as electricity, gas and water networks that can become 'anchor' institutions in a community, or where people have a particular community of interest, albeit sometimes virtual, such as green energy, fuel poverty, clean rivers/beaches or wider climate change. Social media can enable these groups to coalesce and assert themselves in public discourse on energy and water issues and in terms of service delivery.



Source: Ofgem, RIIO2 Framework decision, July 2018; Water UK, Ambitious new vision for water, September 2018; Ofgem, Bills, prices and profits; Discover Water.co.uk; Ofgem, Retail market indicators, 2018; CCCW, Tracking survey, 2017; and Institute for Customer Service, 2018, UK Customer Satisfaction Index, July 2018

Challenge 4:

Role of the state and policy and regulatory frameworks in flux

The profound shift from government responsibility to energy and water companies for what were traditionally perceived as welfare matters is now firmly established (eg the Warm Homes Discount, energy safeguard tariffs and social tariffs in water). The impact of such changes is, however, poorly understood and can lead to perverse outcomes.[12]

As the state has shrunk over the past decades, in many respects it has left a vacuum that many members of the public have looked to responsible businesses to fill. This hole is likely to get bigger as public services are squeezed further (eg NHS, Local Authorities, education services), and as institutions that were previously able to help support people in hardship struggle to get funding. As job insecurity increases (eg as a result of automation), and if Brexit has a negative effect in line with IMF and other forecasts, some of these issues could become even more acute. Already, state support for many of those on low incomes is falling in real terms, rents are increasing and rising employment is no longer reducing poverty.[13]

Many consider that the status quo is no longer an option. Policy and regulatory frameworks are struggling to play catch up with the pace of change. They seem unable to recalibrate or to facilitate system solutions which address social, environmental and technological pressures. The demands of these many challenges also mean that legislative and policy time for tackling new issues – such as establishing the policy and regulatory framework for adapting to new technologies – has become scarce.

Electricity, gas and water companies face particular challenges here as they provide **essential services** plus much of the **critical national infrastructure** and services that form the keystone of what some have called the '**foundational economy**'. Growing social and economic dependency on electricity (to power communications, IT etc) is an additional issue for that sector.

Global companies, which may be head-quartered in countries where prevailing views about the role of the state and social welfare systems are not the same as those in GB, may have different expectations here around what the state and what companies should be responsible for delivering.



Source: IPPR, Prosperity and Justice – a plan for the new economy, September 2018; Trussell Trust, Benefit levels must keep pace with rising cost of essentials, April 2018; and NIESR, Is NHS Funding in Crisis? 2017

What might a 'Sustainable Licence to Operate' cover?

A 'Sustainable Licence to Operate' – an adaptable framework

This 'Sustainable Licence to Operate' framework is **not intended to be prescriptive** but rather something that energy and water companies can adapt – in conjunction with their investors and stakeholders - to suit their own business requirements and **to put their public purpose values into action.** How they do this **will depend** on the sector (electricity, gas or water), where they sit in the value chain, where they are in their evolutionary journey (eg incumbent or new entrant, new or legacy systems), whether they are visible to the end consumer, who their stakeholders and investors are etc.

Some **very initial** supplementary detail on how companies could use the 'Sustainable Licence to Operate' to drive their actions is contained in the attached **Appendices**. These – along with this whole strawman - will be tested with stakeholders over the next 18 months and refined accordingly.

This strawman proposes that a 'Sustainable Licence to Operate' is built **on four 'pillars.'** Summarised in Table 2, the four pillars are:

- **Public purpose, philosophy and public service values** – and the key drivers that can embed these in company culture. This could be articulated in a '*Statement of company purpose philosophy and values'*;
- **Approaches to make best use of different types of 'capital'** – competition and collaboration. This could be articulated in a '*Decision making framework for thinking about competition and collaboration'*;
- **Roles and responsibilities** – expectations and working with stakeholders on what is fair. This could be articulated through possible '*Compacts for fairness*;' and
- **Strategy and narratives** – conveying a positive, honest future road-map for the company and sector. This could be articulated through '*Honest, consistent and integrated reporting for the sector*.'

Basis for choosing the four pillars

The four pillars were initially identified by Sustainability First as being the key areas that energy and water companies need to address to retain a 'Sustainable Licence to Operate' in our New Energy and Water Public Interest Network (New-Pin) project. New-Pin identified that most companies are already doing much constructive work under each of these pillars. However, it also found that more needs to be done to pull this work together, explore the interdependencies between the different pillars, assess how this approach can best be embedded in company culture and understand the implications of this thinking for policy and regulation.

Desk research on fairness, corporate governance and culture, responsible investment and new economic thinking on capitalism has also been carried out to refine our proposals on the four pillars further.

Table 2: Developing a 'Sustainable Licence to Operate' for Energy & Water Companies - Summary of framework and issues

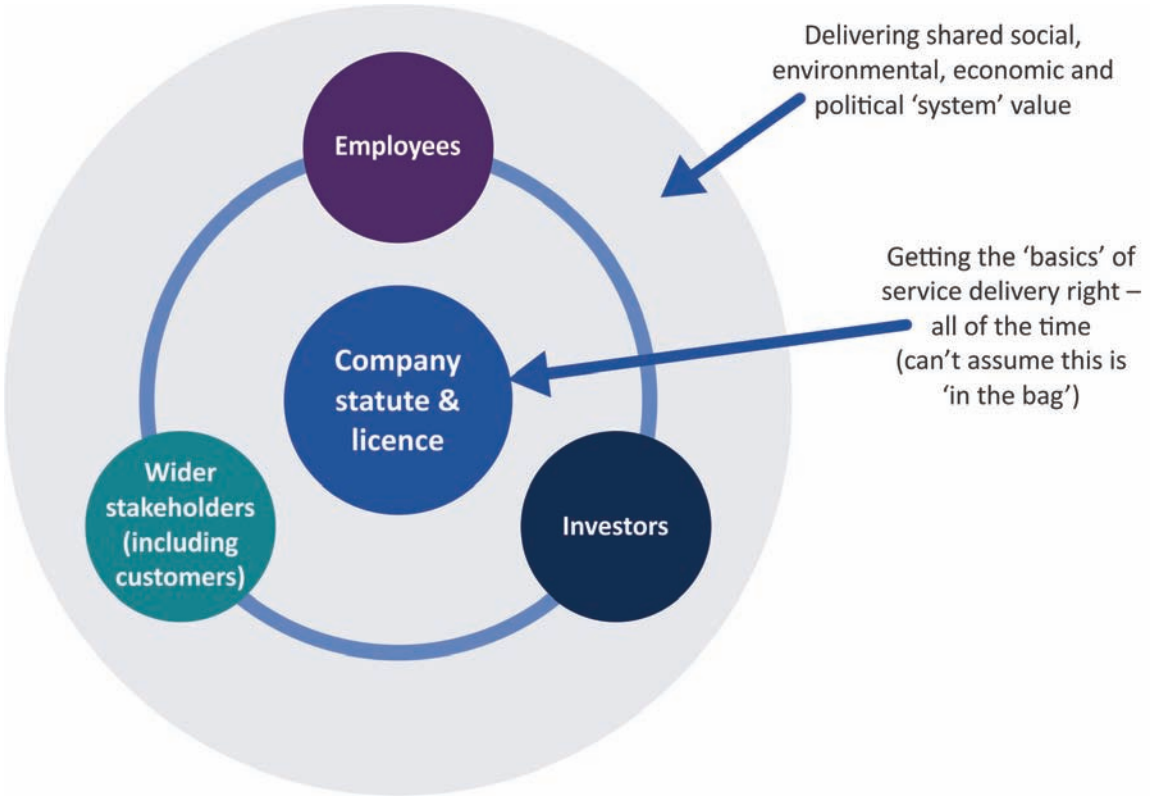
	Pillars			
Four Pillars core topics around which to structure and build a 'Sustainable Licence to Operate' with a particular focus on fairness and the environment	**1. Public purpose, philosophy and public service values** Key drivers that can embed public service values in company culture	**2. Making best use of 'capital'** Approaches to make best use of capital (natural, manufactured, intellectual, social/relationship, human, financial & data) – competition and collaboration	**3. Roles and responsibilities** Expectations and working with stakeholders on what is fair (short and long-term)	**4. Strategy and narratives** Conveying a positive, honest future road-map for the company and sector
Key questions for each Pillar – to focus / shape the content of a 'Sustainable Licence to Operate'	• Investor characteristics & ownership structures • Board governance and company & employee culture	• Response to digital / AI • Moving beyond compliance - impact on competition, policy and regulatory structures	• Options for delivering fairness • Step change for stakeholder role	• Demonstrating a coherent & integrated approach • Role for public interest metrics in assessing progress
Initial content of a 'Sustainable Licence to Operate'	• Investor characteristics • Ownership models • Corporate structures • Balancing stakeholder considerations • Governance approaches • Desired returns • Remuneration • Service ethos / conduct	• Incumbency/new entrants • System wide & systemic issues • Supply chain • Partnership governance • Institutional governance • Competition, policy & regulation	• Fairness • Transparency on approaches to cross-subsidy • Universal Service Obligations • Purposeful engagement • Consumer / Citizen • Trust	• Integrated reporting • CSR • Positive Leadership • Brand • Communications • Third party endorsements
How could a 'Sustainable Licence to Operate' potentially be articulated under this pillar?	**Statement of company purpose, philosophy and public service values**	**Decision making framework for thinking about competition and collaboration to make best use of capital**	**Compacts for fairness**	**Honest, consistent and comparable reporting for the sector**
Outcomes for a 'Sustainable Licence to Operate'	We will identify which of the New-Pin public interest outcomes are relevant under each pillar & how these could best be assessed: VFM, quality, clean, resilient, place-based wellbeing and fairness (within and between generations)			

Source: Sustainability First

Pillar 1: Public purpose, philosophy and public service values

Electricity, gas and water companies that want to retain a 'Sustainable Licence to Operate' need to have a continuing and balanced dialogue with their employees, investors and wider stakeholders (including their customers) as to whether: (1) they have got 'the basics' of service delivery right and are compliant with their statutory and licence obligations (including in terms of fairness and the environment); and, once they have re-assured themselves of this, (2) how they may need to *reinterpret* their public purpose for the future given the exponential changes faced in the sectors. In doing so, they are likely to need to examine what the associated public service values could be for a future looking company. This dialogue between all the company's stakeholders needs to recognise that the electricity, gas and water sectors deliver essential services/public goods and are a key part of social, environmental, economic and political 'systems.' This is illustrated in Figure 4. The company may find it helpful to capture this thinking in a statement of purpose and public service values and be able to articulate their philosophy for achieving this.

Figure 4: The context in which decisions around public purpose and public service values need to take place in energy and water companies



Source: Sustainability First

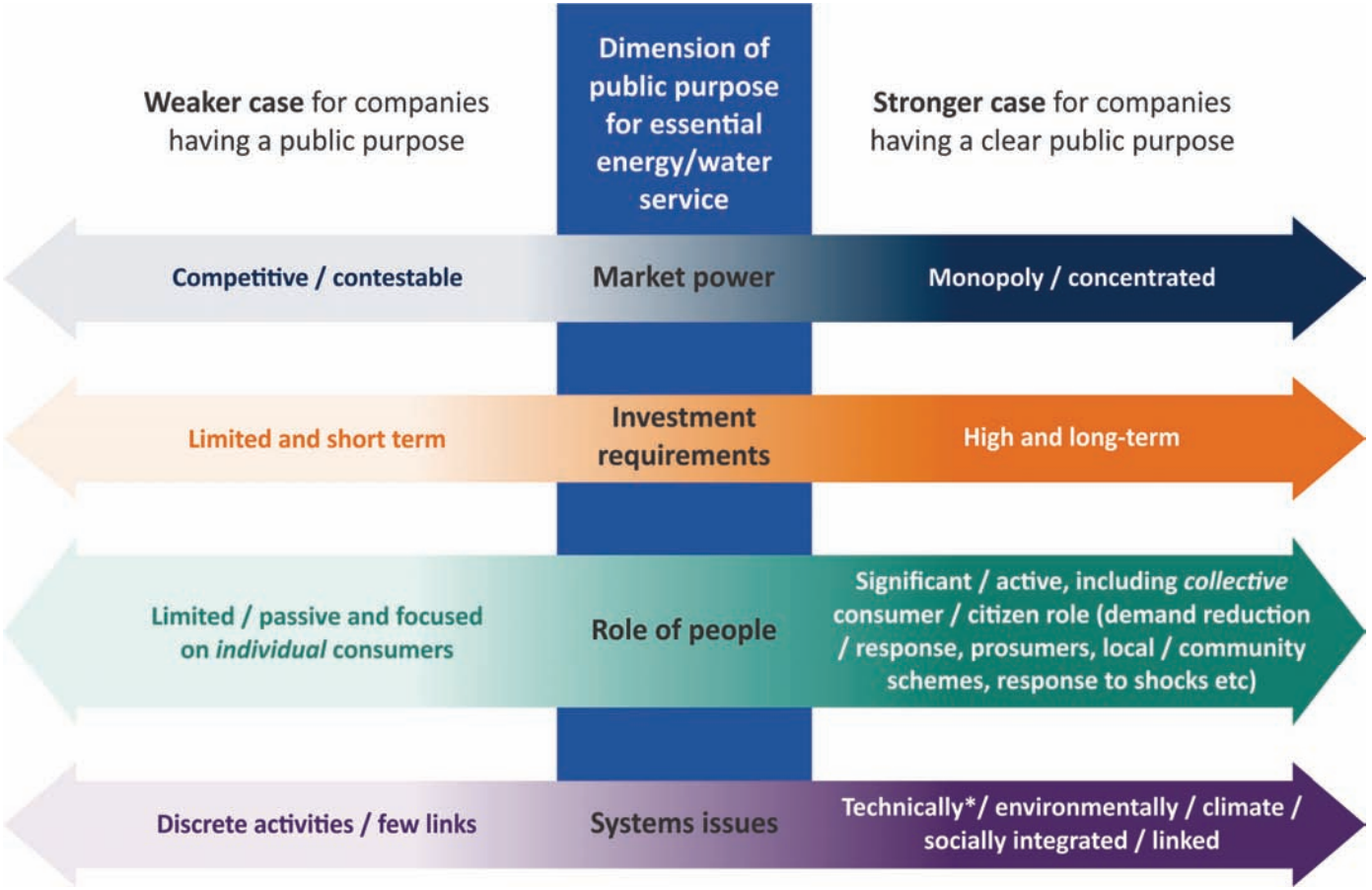
Reinterpreting public purpose for the future

Given the profound changes the electricity, gas and water sectors face, to *retain* their 'Sustainable Licence to Operate,' future looking companies may want to revisit their licence and statutes and ask *whether* they have a wider **public purpose**, and if so, how this may need to evolve. In doing so, it is important to look at the context and systems in which the company operates and how these are changing.

Recognising the key fact that energy and water are **essential services/public goods** that provide value to local and national GDP, it may be helpful to consider public purpose across **four dimensions**: market power; investment requirements; the role of the company in terms of its relations with people (as consumers /citizens/communities) in delivering/managing a universal service; and 'system' issues.

Figure 5 indicates that where these dimensions of public purpose are 'strong' (monopoly power, high and long-term investment requirements, a significant demand side role for consumers/citizens/communities and complex systems issues), there is likely to be a greater case for companies having a clear and strong public purpose. Much will depend on where the company sits in the value chain, if they are a new entrant/incumbent etc.

Figure 5: Four possible dimensions of public purpose that can help shape a water or energy company's actions in delivering public service values



**Including using expertise to co-ordinate systems*
Source: Sustainability First

Traditional economic approaches have focused on the first two of these dimensions; on reducing 'harm' and ensuring returns are 'fair' (in a fairly rigid, financial/legalistic and technically defined context). Behavioural economics, systems thinking, and the political, social and environmental sciences are increasingly drawing attention to the latter two dimensions of public purpose.

These disciplines recognise that people have multiple roles in their lives, that our lived experience is going through profound change (eg the impact of automation on jobs, an aging society with increased disabilities etc) and that people live in communities and places that are influenced by – and through feed-back loops in turn shape – environmental and social systems. This new focus is future looking, more inter-disciplinary and creatively seeks to maximise opportunities (not just minimise threats). Discussions about public purpose need to recognise this new evolving landscape and that new tools and approaches need to be developed to address these issues.

Drivers to shape and embed purpose and values

The following drivers can shape/embed purpose and values within all companies. They require particular focus in companies that have a public purpose.

Ownership models, investors and corporate structures: Blanket generalisations about these factors can easily become misleading. Although some of the different arrangements being proposed by the Labour Party and others in these areas clearly aim to address fairness issues and would undoubtedly lead to a shift in focus/different priorities in decision making,[14] it is worth noting that there are examples of 'good' and 'bad' organisations in privately owned energy and water companies just as there are in public sector bodies and even charities. Arrangements are also actively changing and there are pros and cons on all sides. The following factors that can influence purpose and values need to be considered: the range of investor/owner interests (what do they expect to get out of this/what are their motivations and is this reasonable?); the degree of influence of investors/owners; whether accountability is 'meaningful'; the extent to which investors/owners are able to take a long-term view; and whether they understand the communities the company operates in.

Corporate governance: Given the challenge of drawing any general conclusions about ownership and investor models for the water and energy companies, within a polarised political debate, a clear focus on the role of corporate governance frameworks in delivering public purpose is perhaps more helpful. **After all, the question of what good governance looks like in energy and water will persist – whoever the owners and investors are.** Corporate governance has been the subject of much discussion. It is changing, both at a generic level (Section 172 of the Companies Act 2006, The Companies Miscellaneous Reporting Regulations and the Financial Reporting Council's new Corporate Governance Code), and at a sector level. Ofwat/DEFRA have introduced moves intended to change company behaviour around gearing; which at high levels can lead to increasing returns on equity that many may view as 'unearned' benefits that should be shared with bill payers in the interests of fairness.

Company culture: Companies need to ensure that their purpose, values, strategy, organisational design, business model and objective setting/rewards processes are aligned. Being able to clearly articulate their philosophy can help bring these things together. 'Theories of change' may also help companies consider how they operationalise the desired culture. Each company needs to own their own values but stakeholders may expect a company with a public purpose to have 'public service' values. In the energy and water context these may include: accountability; respect and integrity; openness and honesty; objectivity and collaboration; and leadership. These values are considered in more detail in Appendix 1.

Policy and regulatory frameworks also influence each of the above drivers. Although these are clearly important, companies wishing to retain a 'Sustainable Licence to Operate' will want to look beyond specific regulatory incentives to how their purpose and values can motivate staff, attract the 'right' types of investors for the business and ensure future returns - and ultimately the long-term viability of the company.

With the move to more principles based and less prescriptive regulation, regulators may also want to consider what attention they give to statements of public purpose, philosophy and values and whether this may require changes to licences or whether changes in wider corporate governance and broader ethical and reputational regulation are sufficient to drive desired behaviours.



Snap shot of energy network and water company purpose and values – some examples

We examined the websites of 28 electricity and gas networks, water and sewerage companies – plus a small number of water-only companies - to see how they chose to communicate their stated purpose and values. The following word clouds capture the most frequently-used words to describe these.

Company purpose



Company values



To enable effective peer scrutiny, values must be transparent and shared. We therefore looked at how accessible certain company information was on websites. Whilst most companies do make information on purpose and values easily accessible, for a significant minority, this is not always so.

How accessible was the company's vision / purpose on their website?	
Easily accessible	82%
Not easily accessible	18%
How accessible were the company's values on their website?	
Easily accessible	79%
Not easily accessible	21%
How accessible was the company's code of ethics / conduct on their website?	
Easily accessible	71%
Not easily accessible	29%
How accessible was the company's taxation policy / strategy on their website?	
Easily accessible	75%
Not easily accessible	25%
Is the company's 'speak up' or whistleblowing policy in their Annual Report?	
Companies including this policy in their Annual Report	1
Has the company signed up to the 'Living Wage Mark'?	
Yes	14%
No	86%

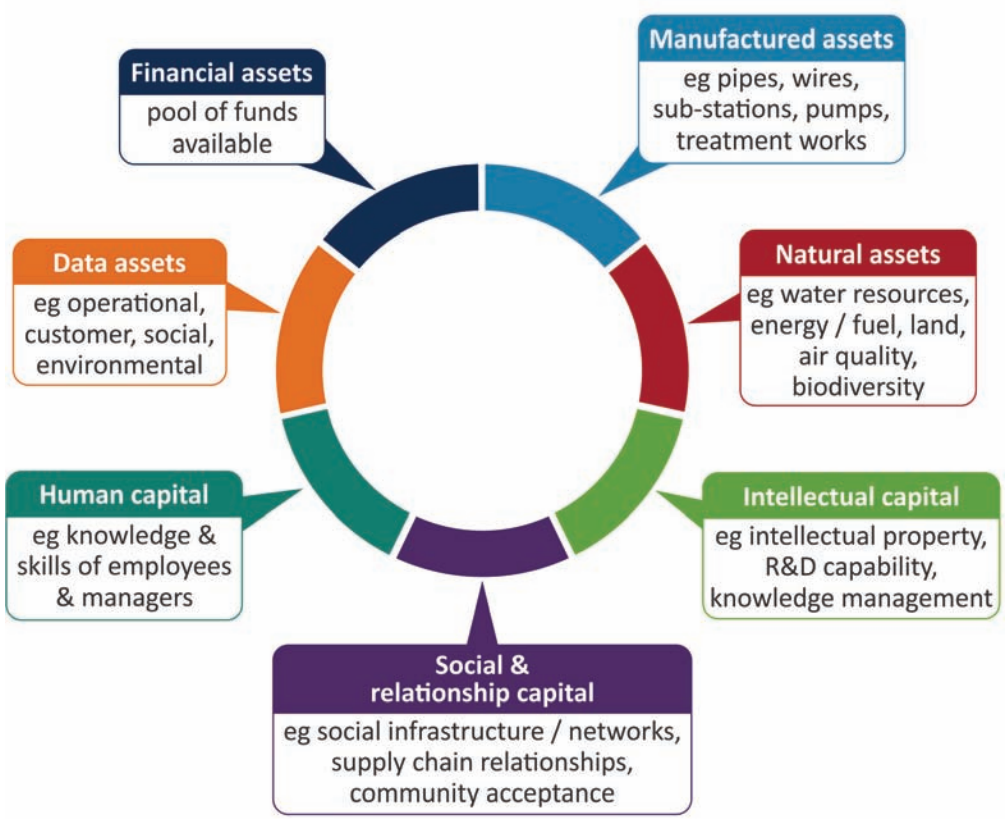
Most companies looked at have already addressed the question of purpose and values at a basic level. However, adopting a 'Sustainable Licence to Operate' might help drive these statements into practical actions across all their areas of activity.

Source: Sustainability First
Research carried out in July 2018. Important to note that this research did NOT include energy retail companies

Pillar 2: Approaches to making best use of different types of 'capital' - Competition and collaboration

Existing energy and water companies already have valuable assets (see Diagram 1). Water companies in particular are custodians of precious natural resources. Given the disruptive changes being faced by the sectors, how they make effective use of these assets, and assess if they need other types of 'capital' in order to deliver their public purpose and contribute wider systems value, is a matter of deep importance. The topic of where and how to collaborate and/or to compete to make best use of assets poses a significant conundrum for companies in today's energy and water sectors – be they in competitive or monopoly parts of the value chain (although it is more of an issue in energy). To retain a 'Sustainable Licence to Operate' electricity, gas and water companies must give more thought to how they *both* compete *and* collaborate if they are to deliver on public purpose and create wider 'systems' value. Business models, and policy and regulatory frameworks, need to be reviewed in this light, but regulators and government appear to believe there is more 'flex' in current arrangements than some companies may perceive. The decision-making framework in Figure 6 may help companies tackle what an appropriate balance between competition and collaboration looks like for them, when to use which approach and with whom.

Diagram 1: 'Capital' inventory – what different types of capital does the company have to deliver its public purpose and create systems value?



Source: This is based on the 'six' capitals used by the International Integrated Reporting Council[15] but with the addition of a separate capital of 'data' assets

Different types of capital in the energy and water sectors

Diagram 1 outlines at a high level the different types of capital that energy and water companies have - and may need - in the future. Much of the focus of policy makers, economic regulators and companies in the sectors over the last few decades has been on financial and manufactured capital. This has been due to a variety of factors including the monopoly nature of many of the assets and degree of investment required. With the need for greater flexibility to cope with disruptive change, there is now an increasing focus on human, social/relationship and intellectual capital. There is also an increasing interest in natural assets and 'green infrastructure' as a way of delivering both flexibility and wider environmental benefits (particularly in areas that may have previously proved 'difficult' such as flooding and air quality). The exponential increase in the importance of data, and recognition that new insights are often best achieved by combining information from multiple sources, are leading to new questions of how best to make use of this new type of capital.

Policy and regulatory frameworks for competition and collaboration

Competitive and collaborative approaches both have benefits and short-comings in terms of making best use of assets to deliver long-term public interest outcomes. Policy and regulatory frameworks undoubtedly shape company decisions in these areas. To date, these have predominantly prioritised competition-led approaches. In the energy sector in particular, the focus has traditionally been on retail competition for end - consumers. This is now starting to change and different routes to contestability are being explored in both sectors.

Although competition by its very nature is dynamic, innovative and the outcomes are often varied, it's strengths are in delivering optimal efficiency in the interests of individual 'customers' – in the expectation that this will translate into wider societal benefits – and outcomes that you can relatively easily 'put a price on'. As New-Pin found, competition can struggle to deliver long-term public interest outcomes such as long-run resilience, place-based well-being and fairness (see Figure 2). Interventions, and collaboration and partnership work, may be more effective at delivering some social programmes – as well as more 'citizen focused' outcomes – along with wider systems benefits.

Concerns around the limits of contestable approaches are leading to increased focus on ensuring that arrangements do not 'leave anyone behind' – and questions around who should bear the associated costs for those who are not digitally connected etc. There is now a growing interest in managed markets, political solutions that are not market based and in collaborative approaches and different types of partnership arrangements. Although reviewing when competitive and when non-contestable/collaborative approaches are appropriate is healthy, it may not serve the long-term public interest well if the pendulum swings 'from one extreme to the other'. **A case by case approach is needed to decide when to use competition and when to use collaboration – and how and for which types of capital - to deliver public purpose and systems value**.

It is also important to note that for GB energy and water companies, policy and regulatory frameworks were designed for an analogue age and may potentially 'get in the way' as companies try to decide how best to now compete/ collaborate for delivery of their wider societal purpose in the digital world.

Incumbent providers face the added problem that current approaches to regulation may inhibit their ability for competitive innovation or entering into new collaborations. They are at risk of challenge from disruptors that may become, and in some cases already are, dominant platforms that unlike them, may not have licence conditions that formalise their responsibilities as part of the energy and water ecosystems. There is a risk that the information asymmetries that always exist in markets may become 'supercharged' if the use of data by dominants leads to a winner takes all environment.

Changing business models

The approach taken to competition and collaboration can influence the business model of the organisation. Digitisation has radically disrupted existing business models. This is already apparent in energy retail – and will become increasingly so for energy and possibly, but to a lesser extent, water networks (eg through sensors, predictive analytics and energy/water saving apps). Low entry costs, new technologies, new sources of information and skills which do not recognise geographic boundaries have given birth to a vast array of new types of company. Fast failure and experimentation are rapidly refining even new business models.

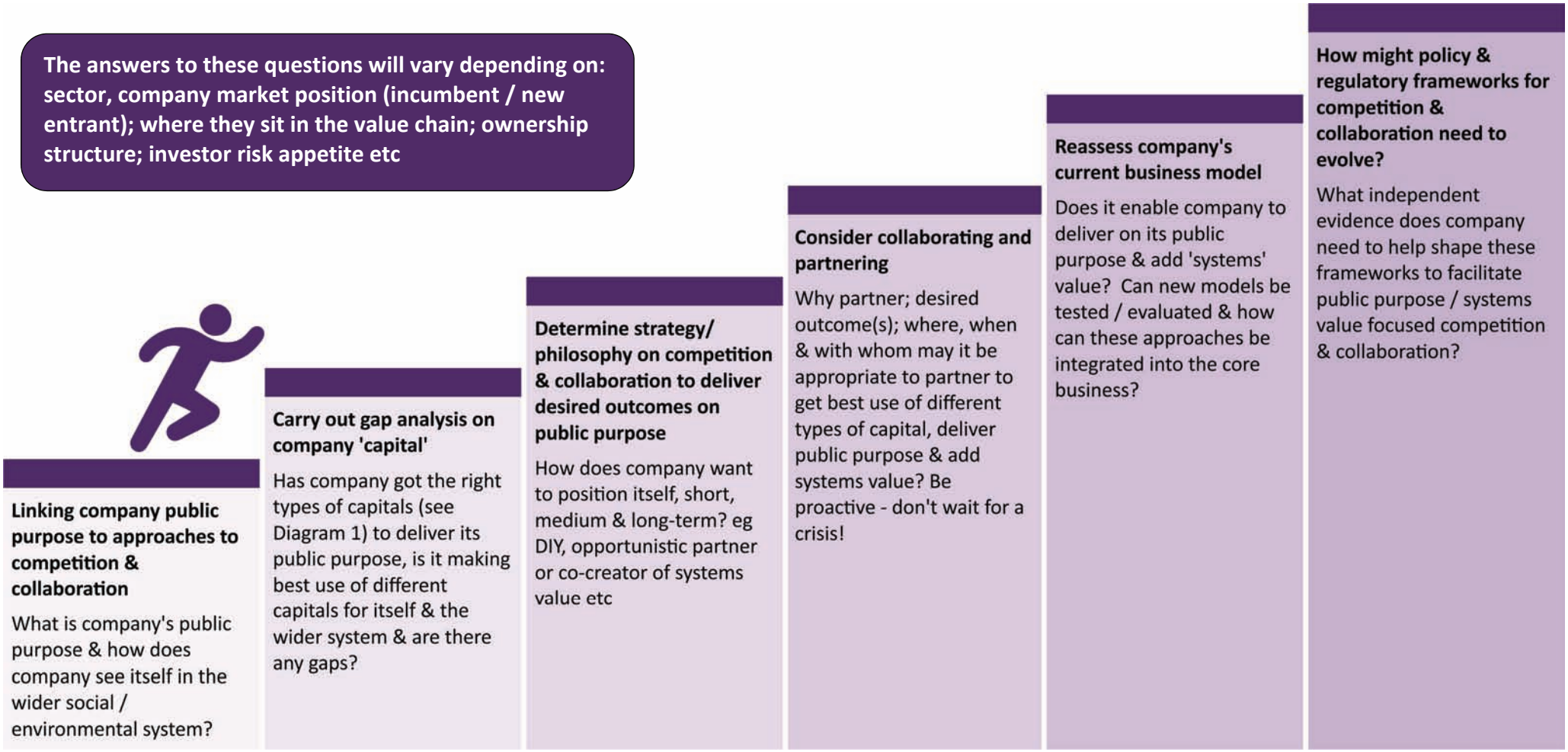
Appendix 2 provides a more detailed analysis of the different business models that are emerging across the economy that enable greater collaboration (such as platforms). To help meet the UN's Sustainable Development Goals (which will require a step change by 2030 for global businesses), the UN Global Compact and Volans advocate that future business models need to be based on the following dimensions:

- **Social** – delivering both financial/extra financial value through positive impacts for people—in the present and in the future (eg peer to peer).
- **Lean** – optimizing the use of all forms of business 'capital', seeking efficiency across silos and using affordable innovation.
- **Circular** – sustaining inputs and outputs at their highest value in both technical and biological cycles and by looking at closed loops.
- **Integrated** – managing both financial and 'extra-financial' value creation across economic, social and environmental systems using seamless data flows and often through internalising positive and negative externalities.[16]

There are fundamental questions here about what this all means for providers of essential services, particularly when these are delivered through monopoly assets. For example, existing electricity, gas and water networks could potentially become '**public purpose platform' businesses** that provide a platform for other companies/actors to deliver services from. Innovation in business models may also include new mechanisms that facilitate '**value stacking'** or '**layer benefits'**[17] of other services that may deliver wider public/systems outcomes but may not on their own pass standard cost benefit analysis tests.



Figure 6: Competition and collaboration: possible six step decision-making framework for electricity, gas and water companies

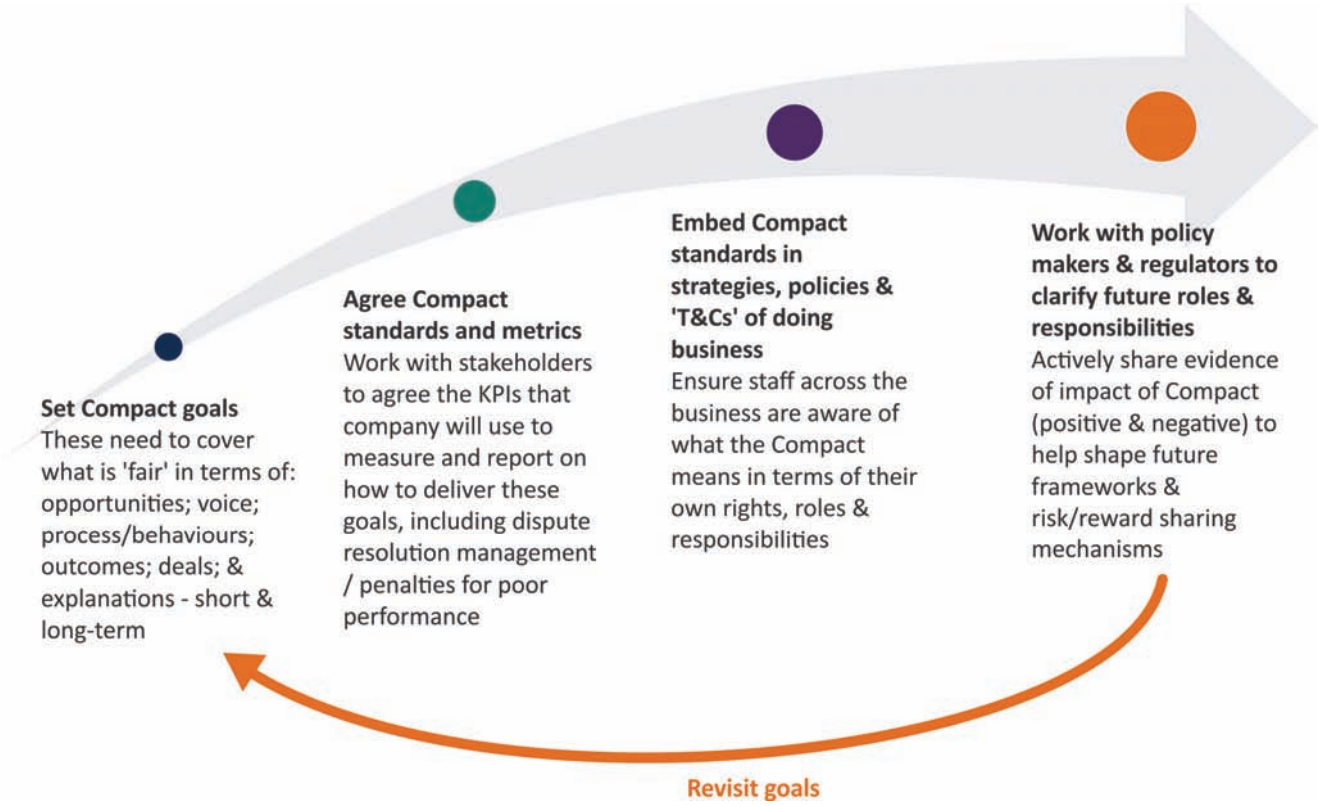


Source: Sustainability First

Pillar 3: Roles and responsibilities – Expectations and working with stakeholders on what is 'fair'

For all actors, clarity around legal obligations, roles and responsibilities and policy and regulatory requirements is important. Without this, energy and water companies can be reluctant to act through fear of incurring unnecessary costs or misinterpreting what is required and facing financial penalties and brand damage as a result. During times of significant disruption, companies that seek a 'Sustainable Licence to Operate,' will not just sit back and wait for clarification to comply with new rules. Instead, they are likely to actively engage with their stakeholders to foresee and pre-empt change with corporate commitment to go 'above and beyond' legal compliance and minimum standards. In doing so, they are likely to seek to determine how to strike a 'fair' balance between the interests of all connected with the business for both today and tomorrow. Agreeing 'Compacts for Fairness' with their stakeholders, as summarised in Figure 7, may be a helpful way of thinking about this.

Figure 7: Illustration of how a 'Compact for Fairness' for electricity, gas and water companies might work



Source: Sustainability First



Fairness for and to who?

Fairness is a relational concept. So, ensuring that actions and decisions are as fair as possible from the **point of view of all key stakeholders** – consumers, citizens, the wider environment, investors as well as 'workers and bosses' - is crucial. Each group may have a different interest and perspective on the various dimensions of fairness, and these may also vary between nations and regions (eg the Welsh Government's Future Generations Act, the Scottish Government's clear fairness agenda and initiatives like Manchester's Generations Together programme). The **broad dimensions of fairness** include:

- fair '**opportunity'** to access services;
- fair **say or 'voice'** in setting purpose, values, objectives and shaping services. Giving people the opportunity to express their views and assurance that they were considered by decision-makers. This is particularly important for those without an 'obvious' voice (eg nature and future generations);
- fair **processes and behaviours** – including respect. As there may always be some form of discrimination (positive or otherwise), the idea of behaving in a way that is right and reasonable (i.e. in a moral way), including through redress processes when things go wrong, is important;[18]
- fair **outcomes** in terms of the services delivered and any associated impacts;
- fair **explanations** of decisions and actions. Reasons should be given as to why a decision has been reached, or when something goes wrong. [19]

Building on these broad dimensions of fairness, to stimulate discussion, Table 3 proposes what a 'typology' of fairness might look like in the sectors.

Table 3: What might a 'typology' of fairness look like – and how might this be best delivered by policy makers, regulators and companies?

	Linked steps to delivering fairness	How might this be delivered by policy makers & regulators?	What might companies do?
1.	**Fair choice -** is it a natural monopoly? Will it reduce or enhance natural capital?	Policy – market-led approaches possible? Regulation – price controls plus incentives for vulnerability & collaboration	More collaborative and co-creative initiatives where monopoly may struggle to deliver public purpose/systems value -or where other stakeholders can help; transparency of prices/returns; assessment of natural capital impacts
2.	**Fair opportunity** - to access services • For individual consumers • For groups of consumers	Licence conditions Guidance on differential pricing	Going above and beyond licence requirements; helping customers to understand and own their own data to change behaviour; help accessing services/grants & making informed decisions about tariffs; capacity building of third sector groups
3.	**Fair say / voice** – on services • Current users • Future users • Employees • Wider stakeholders	Regulatory principles/ frameworks for consumer & wider stakeholder engagement – that recognise the importance of collaboration	Embedding user, future user and environmental input in planning, identification of performance metrics, contractor selection, feedback, peer to peer assessment etc. Co-designing services, particularly where there are long-term impacts (eg catchment management) or where outcomes only likely to be achieved by different actors coming together (eg biodiversity or fuel poverty schemes)
4.	**Fair say / voice** – on purpose / values	Regulation/governance/ stakeholder engagement	Embedding user and community input in planning and feedback; go beyond regulator required engagement; adopt stakeholder-led agenda and priorities; avoid tokenism by involvement of diverse non-Exec directors to protect interests of customers, environment and public
5.	**Fair process** • Transparency • Honesty • Respect etc	Regulatory principles/ conduct/ethics/values. Requirements on companies to explore distributional impacts (short & long-term) of policies	Demonstrate throughout governance structure and in reporting; needs to be consistent across the business and supply chain, to avoid charges of hypocrisy; independent assurance of company outcomes. Clear and transparent assessment of distributional impact of strategies for both today and tomorrow. How things like social tariffs and environmental levies are applied may be viewed as just as important as what these may be

	Linked steps to delivering fairness	How might this be delivered by policy makers & regulators?	What might companies do?
6.	**Fair outcomes** – as consumers, producers, 'polluters' and 'emitters' • Customers in vulnerable circumstances • People unwilling to engage • Addressing underlying social inequalities – 'moral redistribution' • For all – current and future (including nature)	• Cross-subsidy • Social tariffs • USOs • Legal standards • Licence conditions • Political interventions – price caps etc • Policy frameworks eg CMA	Work with government and regulators to clarify who pays for what – and what might comprise a 'universal service' offer. Understanding segmentation of customers better; more proactive identification and reaching out to consumers in vulnerable situations and those unwilling to engage; active programme of enabling customers (especially in vulnerable situations) to understand and to use their data to bring about behavioural change and/or to get the best deal tariff-wise; provision of schemes to enable these customers to be early-adopters of new technology/benefits; greater consultation and engagement with those that will pay for cross-subsidies/social/environmental initiatives
7.	**Fair deals** – balancing risks and rewards • Sharing outperformance • Partnerships • Ownership	Price control negotiated settlements Fairness compacts New ownership models	Avoiding super/'unearned' profits; ploughing back profits to cover past legacy and future costs; greater transparency of costs/rewards beyond accounting norms; ethical approach in dealings with supply chain. Recognition of long-term impacts
8.	**Fair explanations** –Clear and credible? Do perceptions match reality?	• Assurance mechanisms • Independent verification • Regulatory 'open hearings' • Parliamentary scrutiny	Independent assurance mechanisms; open reporting; accountability to stakeholders not just to company board/shareholders/ regulator & government. Regular and transparent reporting. Greater understanding of any difference between perceptions and 'reality' and action to close/bridge that gap

Source: Sustainability First

Expectations around fairness

Expectations on what is 'fair' in the sectors, and even the language associated with this whole area, is changing. Norms are shifting towards a greater focus on ethics and morality and social and environmental justice. The factors that are driving some of these changes in thinking include:

- **Changing state / business relations**: what the company is doing to be a 'respected corporate citizen' and how it is showing moral leadership through identifying and helping to address mutual solutions to common problems is a growing issue for all companies but a significant one for providers of essential services that play a key role in the eco-system and that are considered to have a 'privileged' market position and/or to be 'custodians' of precious natural resources or critical assets;

- **Desire for greater 'control:'** this can vary widely between (and within) groups including consumers (personalised services), citizens (democratisation), workers (ownership, new business models) and communities (eg place-based needs, going 'off-grid,' or pushing for higher protection of local natural resources etc). These trends don't necessarily all pull in the same direction and can lead to new questions of how to balance different interests in a fair way.

- **Shift from vulnerability to 'fairness for all**:' public discourse is moving from seeking outcomes which may be 'optimally efficient' for those that shop around, coupled with protections for those in certain vulnerable groups, to seeking outcomes which are 'relatively' efficient and are therefore likely to assist any person that may be in a vulnerable situation alongside those that do not want to engage;

- **Move to service business**: on top of being the bill payers that are expected to fund future investments, consumers and communities are likely to need to play a greater role in the sectors going forward to provide flexibility and deal with 'shocks' (particularly in energy). This will impact on expectations of how risks and rewards are shared in a fair way; and

- **Cross sector approaches to dealing with fairness**: as multi-utility and 'home' service packages develop, expectations on joined-up support, service provision, carefully managed data sharing – along with redress when things go wrong - are increasing.

Uncertainty around who is responsible for what can be damaging on all sides. Developing 'Fairness Compacts' with their stakeholders may help electricity, gas and water companies clarify how far they themselves can address these issues and, in the process, help determine how policy and regulatory frameworks may need to also change. It is important that corporate leadership in this area is not seen as removing the need for democratic decisions on judgements about fundamental social and environmental trade-offs.



Pillar 4: Strategy and narratives – Conveying a positive, honest future roadmap for the company and sector

Plato famously said that 'storytellers rule the world.' Getting a robust strategy in place up front, and *only then* developing an accompanying narrative around this and set of metrics to sit beneath it, is vital to build legitimacy. The order is important to avoid spin and for 'the story' to be truly authentic. Over a long period, energy and water sector data has become ever-more detailed – but at the same time arguably more piece-meal and 'de-centralised', neither readily conveying the 'big picture' on fairness nor the environment for either sector. If companies are to retain a 'Sustainable Licence to Operate,' there needs to be a step change from current approaches to company reporting to sharing data and explaining information. This in turn needs to become part of a more credible and integrated strategic narrative - firmly focused on the long-term public interest outcomes for the company but crucially also for the wider sector. There can be a 'catch 22' here. When trust and confidence in the sectors are low, there can be pressure on policy makers and regulators to ask for ever more detailed reports. This can be really important to tackle specific issues. But it carries the risk that internal and external stakeholders can't see the bigger picture. Emerging trends, links between companies and activities and cross sector outcomes risk being over-looked. Chairs and chief executives need to lead - and reshape their company and sector reporting to demonstrate the big-picture. Figure 8 attempts to show how companies can start to shift the dial.

'Narrative' reporting is becoming increasingly 'in vogue' across the business world. It has a particular importance in the energy and water sectors as private companies delivering what many consider to be public services need to be able to **demonstrate**: that as a company they are fulfilling their 'public' purpose and acting 'fairly' to all stakeholders; and as a corporate leader they are working with their peers across the energy and water sectors to deliver wider systems value. Doing this in a way which is meaningful to stakeholders without leading to charges of hypocrisy or just adding to the reporting 'burden' can be a challenge.

Many companies now sit in the middle column of Figure 8 and there are examples of cross-sector reporting (eg Discover Water and the data-set being developed for the ENA Platform). To get a more fundamental shift to the right of the diagram, companies may want to consider how best to:

- **Engage with stakeholders**: What is reported is crucial. A company, and the wider sector, needs to know its 'audiences' if it is to understand what information different groups may require or consider relevant in terms of their delivery of their public purpose and wider systems value. Engagement is also key to getting the 'right' language, tone and timing/choreography of any communications – and ensuring that people can 'identify' with the narrative;

Figure 8: How companies may be able to demonstrate to stakeholders that they can have confidence in their work through 'shifting the dial' on reporting

Traditional reporting arrangements	Current good practice reporting arrangements	Future reporting with a 'Sustainable Licence to Operate'
Closed / blame reporting culture	Open / honest reporting culture	Collaborative reporting culture
Detailed data heavy reports	Strategic narratives – by both companies and trade bodies	Coherent cross-sector narratives
Short-term internal data	Data / metrics developed following employee / external engagement	Metrics demonstrate how make best use of assets for the system
Backward looking	Forward looking	Strategic / long-term view
Silo based	Integrated in company	Integrated – cross sector
Measure 'things' / in-puts	Measure company outcomes, culture & behaviours	Measure full range of sector long-term public interest outcomes
Senior team invisible	Chair / CEO show personal commitment	Sector leaders show commitment - together
Self-selecting reporting	Use established frameworks / independent assurance / audits / certification	Learn from each others failures
Company based	Company based	Sector / systems based
Tailored / specific metrics	Consistent metrics	Comparable across sector
One size fits all publications	Publications tailored to target audiences	Publications help shape policy & regulation
Static / 'sit on shelf'	Iterated	Evaluated

Source: Sustainability First

- **Develop meaningful narratives:** Strategies and narratives need to be underpinned by a set of key metrics that tell the company's – and crucially sectors - story in a consistent and comparable way over time. Digitisation, AI and the increasing possibility of real time reporting should make the task of communicating in a 'meaningful' way with a company's different 'constituents' easier – but may lead to new challenges in terms of keeping a long-term focus. Visuals and infographics can make data more accessible and enable more 'emotional' as well as 'factual' information to be communicated;

- **Develop a positive road-map for the future**: Leading indicators need to be used to help assess progress in the desired direction. These need to be brought together to paint the bigger picture of what the company is doing on its own and with other actors in the sector;

- **Triangulate data to produce integrated reports:** Metrics need to be triangulated and brought together/integrated in a dashboard that provides a holistic view of the company and sector. Commentaries on ethics and culture need to be included to build trust and confidence; and

- **Use reporting frameworks and independent assurance mechanisms**: Accreditations, awards, auditing / certification schemes etc can all provide assurance on how the company is performing. To be credible, these need to be independent. Employee, consumer and third-party views and endorsements are likely to be able to help here (although ensuring these are fair, balanced and true can be a challenge), along with peer to peer reviews and independently run benchmarking clubs. The latter may be particularly important for companies that aren't directly consumer facing. It is important that these frameworks provide space to be open about failure.

Ultimately, to retain a 'Sustainable Licence to Operate' a company and the wider sector needs to be able to provide **compelling evidence** to all its stakeholders not only on whether it has fulfilled its licence obligations and statutory duties but also on how far it is meeting the full range of desirable long-term public interest outcomes for the sector in a balanced and fair way.

Policy makers and regulators can play a role here by thinking carefully about the metrics they use to judge successful delivery of outcomes (eg by developing a full range of coherent long-term public interest metrics themselves, including for things like market health and environmental outcomes), the information requests they make (including detail, frequency and co-ordination between departments/bodies), ensuring that they actually use the information they collect and their own accompanying strategic narratives. When there are multiple regulators, as with water, co-ordination on these points is clearly important. Creating a climate of trust between all parties, where companies can be open about what has worked and what hasn't, is important.



Developing an integrated and iterative approach to a 'Sustainable Licence to Operate'

The different pillars in the strawman are clearly interconnected and designed to help companies to consider the issues raised in a **systematic and holistic way.** Most electricity, gas and water companies are already addressing many of these issues but not necessarily in this integrated fashion or in an **embedded** way that will survive once the policy / regulatory spotlight changes or leaders move on. This can lead to problems as inconsistencies in approach can erode trust.

Employees play a crucial role here as they are often best placed to be able to identify when leadership teams are not 'walking the talk' in terms of delivering and reporting on purpose and values. They also need to be actively engaged if 'Sustainable Licence to Operate' thinking is to become '**business as usual'** across the company and not confined to certain parts of the business (e.g. customer service, sustainability or CSR teams).

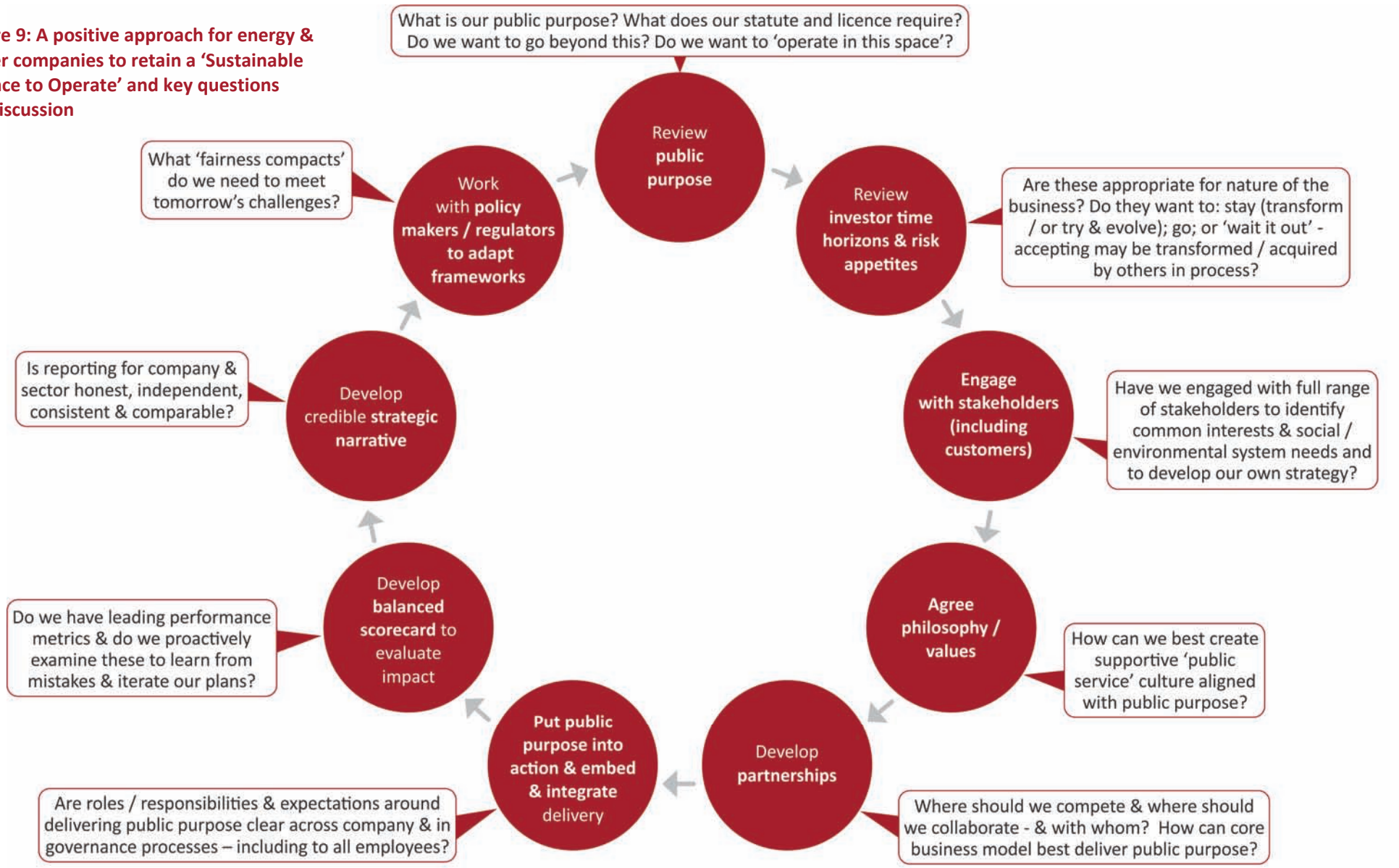
An iterative approach is also important**.** Flexibility is essential given the uncertainties and pace of change – and the likelihood that this could be 'non-linear'.

A summary of a possible way of looking at this can be seen in Figure 9. In asking themselves whether they have a 'Sustainable Licence to Operate', **companies, along with their stakeholders (employees, investors, customers, civil society, environmental groups etc)** may want to consider the associated questions at each stage.

As a cycle of the diagram in Figure 9 completes, all parties will want to consider whether these are still the right questions to ask in terms of a 'Sustainable Licence to Operate' in a rapidly changing landscape. For example, if environmental and climate impacts are more extreme than those currently predicted, it may be appropriate to amend the framework.

The proposals set out in this strawman are very much the beginning of a process. Greater clarity in terms of roles and responsibilities - and what works – will be needed on all sides. Companies cannot achieve the changes needed on their own. However, through demonstrating corporate leadership in the ways outlined in this paper, companies should be able to help clarify how **policy, regulatory and competition frameworks may also need to adapt and change**. As and when companies do this, approaches to principles-based and ethical regulation, both for networks/wholesalers, and also in retail for meaningful principles-based regulation, should become clearer.

Figure 9: A positive approach for energy & water companies to retain a 'Sustainable Licence to Operate' and key questions for discussion



Source: Sustainability First

Appendix 1

Pillar 1: Public purpose, philosophy and public service values

Definitions

A company's **purpose** can be defined as the impact that they want to make on their various stakeholders. Without a clear sense of what they are there to do, companies may struggle to attract and retain suitable capital and customers, inspire and empower their employees, bring in and keep new talent and satisfy their wider stakeholders (including the environment).

A company's **philosophy** is an articulation of their attitudes and 'how they do things around here.' In this way, it links values and behaviours. Philosophy can be a powerful and guiding force for change. The philosophy of an individual company also needs to be seen in the context of the **philosophy of the wider system**. A recent article in the Economist noted that Labour party policy on nationalisation is influenced by 'moral economists' such as Karl Polanyi and warned '*Labour critics should keep in mind the philosophical underpinnings of these policies*.'[20] If a company's philosophy is 'out of step' with wider public moral sentiment (eg that access to energy is a universal right even for those that don't want to engage in the market), it can be problematic.

A company's **values** are a guide to behaviour. They help shape the company's relations internally (with employees and investors) and externally (with stakeholders and wider society). A recent Institute for Business Ethics (IBE) report notes that these external relationships are the ones from which the company derives its licence to operate (clearly, dissatisfied employees can in their turn shape and influence these external relationships). The report quotes Sir Adrian Cadbury as saying '*The issue to keep in mind is that the nature of the boundaries within which companies operate is continually changing. The task for boards and their chairmen is to be alert to the implications of these changes and to foresee their direction.*' [21]



Drivers to shape and embed purpose & values

Driver 1: ownership models, investors and corporate structures

Electricity, gas and water companies are in the front-line of the discussions taking place across the business world as to whether current economic models and ways of working are fit for purpose and fit for the future. In energy and water, this has led to questions as to whether some types of owners, investors or corporate structures may be more 'suitable' than others in the sectors.

As previously noted, blanket generalisations about these factors can easily become misleading. And seeking to attract the 'right' sort of investors when getting new capital is one thing whereas dealing with an embedded investor that may be considered 'unsuitable' is another. In many ways it may be the case that it really is 'horses for courses' depending on a range and interplay of factors that may include:

- **Range of investor/owner interests (what do they expect to get out of this and is this fair?).** There may be less to distinguish between different types of investor than some have suggested. Dieter Helm has said: '*The owners of the publicly listed companies comprise mainly of the same sorts of investors that comprise the funders of the private equity and infrastructure funds owned companies…..The infrastructure and private equity model has tended to be aggressive on financial engineering ….The publicly quoted companies have not however been far behind…. It is a matter of degree and not kind.*'[22] It is worth noting that mutuals such as Welsh Water are likely to be in a slightly different category here. On the other hand, in theory, investors who are 'universal owners' may have such a wide range of investments/asset classes that they actually do have a vested interest in social and environmental sustainability.[23] One would expect publicly owned companies to similarly be focused on questions of public purpose. However, this may be interpreted very widely and extended to ambitious/wider goals such as: strengthening democracy; promoting wider equality/financial security; remedying lack of public funding; and tackling automation/digitisation of the economy.[24]

- **Degree of influence of investors/owners**. Too dispersed, and the management team are unlikely to be meaningfully challenged. Too concentrated, and the management team may not have the ability to challenge strategy or the freedom to make operational decisions or respond to stakeholders. Private equity (non-listed) companies may have greater flexibility to shape management teams than publicly quoted companies. A 'sufficient' number and diversity (including cognitive diversity) of Non-Executive Directors can be an important counter-balance here – particularly in unitary boards. In publicly-owned companies (state or not for profit), political and financial pressures – and lack of know-how - may potentially get in the way of running the business.

- **Meaningful accountability**. Publicly quoted companies (though publication of the share price, Annual Reports and Accounts, AGMs etc) have some 'readymade' accountability mechanisms. These are not present in the same way with private equity (non-listed) companies where unduly complex and opaque corporate structures can exist in some companies. A recent analyst study of the sectors found that listed companies had more independent directors than private companies and that private firms were more likely to reserve strategic matters to holding companies rather than delegating these to the operational company level.[25] Public sector organisations are likely to have more open and democratic accountability checks and balances, including publicly appointed directors, scrutiny by Select Committees, the NAO etc. However, examples from the NHS (eg Mid-Staffs etc) indicate that these don't necessarily always lead to timely/effective accountability.

- **The extent to which investors/owners are able to take a long-term view**. Large institutional investors and some sovereign wealth funds may provide 'patient capital' and invest 'in perpetuity,' being able to take a long-term view (particularly important for infrastructure). Although it is a generalisation, equity investors *can* be unduly focused on short-term returns and taking money out of the business rather than re-investing it for the long-term. On the other hand, too much debt and unsustainable levels of gearing may make the company vulnerable to longer-term shocks in the system.

Initiatives including 'Impact Investing' and the 'B Corporation' movement are encouraging investors and companies to place more emphasis on long-term factors. These initiatives, however, are still relatively small scale.[26]

- **Understanding the communities the company operates in**. Equity investors, particularly in highly competitive markets, should be incentivised to get management teams in place that have a keen sense of what their customers want and drive to innovate to meet their changing needs. Debt investors, particularly in highly leveraged companies, may be so focused on cash flow that they do not enable management teams to have sufficient agility to be able to respond to events, potentially leading to poor standards of service (environmental and in response to disruption). Global investors may have limited familiarity with the wider social/political context of the geographies that they are investing in. Absent purposeful engagement, they may struggle to ensure companies are effectively meeting local needs that extend beyond individual customers to communities and particular stakeholders. Public sector or co-operative ownership, especially if at the municipal or local level, may find it easier to focus on local requirements. Questions of scale may be important here, but these can potentially be addressed through support structures.[27]

Driver 2: corporate governance

Thinking on questions of ownership and investor models are as much influenced by politics as they are evidence-based. Given the challenge of drawing any general conclusions about ownership and investor models for the water and energy companies within a polarised political debate, a clear focus on the role of corporate governance frameworks in delivering public purpose is perhaps more helpful. **After all, the question of what good governance looks like in energy and water (and indeed in other essential services and sectors) will persist – whoever the owners and investors are.**

One of the main areas of focus in debates about corporate governance has been **Section 172 (1) of the Companies Act 2006** which states a director of a listed company must have regard to: the impact of decisions in the long-term; the interests of employees; relationships with suppliers, customers and others; the impact of operations on the community and the environment; and the desirability of the company maintaining a reputation for high standards of business conduct. There have been concerns that these requirements are weak and that the Code has not always led to a 'satisfactory dialogue' with all stakeholders.[28]

There is currently much activity to address these issues in the wider economy -and in the water sector in particular. The Companies (Miscellaneous Reporting) Regulations 2018 require directors of *every* large company - regardless of whether publicly quoted or not - to explain in their strategic report how they have had regard to various matters in performing their duties under Section 172 of the Companies Act 2006. This includes summarising in their directors' report how they have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the year.[29]

At the same time, the Financial Reporting Council has recently published a new Corporate Governance Code which requires the boards of listed companies to explain *how* they have set their purpose and strategy and how they have engaged the workforce and understood the views of the company's other key stakeholders.[30] In parallel, the Wates Review of Corporate Governance Principles for Large Private Companies has proposed a code of practice for non-listed large private firms that would include principles such as ensuring that the board has a responsibility to oversee meaningful engagement with material stakeholders.[31]

These recent statutory and regulatory changes to approaches in corporate governance also need to be seen in the context of the significant activity in the water sector following the Secretary of State's January 2018 letter asking Ofwat to investigate concerns around some water company's behaviour (off-shore financial arrangements, securitisation, high gearing, high levels of executive remuneration and high dividends). Since then, Ofwat have:

- amended the current PR19 price review methodology to require companies to: set out proposals to share benefits with customers where companies have gearing (at the operating company level) that is materially above a notional level that underpins price controls; to explain how dividend policies will take account of how companies deliver for customers over the price control period; and to set out how performance related pay will reward stretching delivery for customers;[32] and
- consulted on a revised set of principles on board leadership, transparency and governance (at the time of writing, out for consultation). These encapsulate elements of the changes above and bring together the existing regulated company and holding company principles.[33]

In water in Scotland, negotiated settlements and an 'ethical' regulatory model provide a different context to questions of corporate governance that places greater emphasis on the roles of different stakeholder groups and on the ethical principles sitting behind the regulator's approach.

Driver 3: company culture

Both water and energy companies can therefore see a clear direction of travel on governance. This leaves companies with a choice: they can await new generic reporting regulations or Ofwat's revised principles. Or, future-focused companies wishing to develop a 'Sustainable Licence to Operate' can actively demonstrate their wish to embrace not just the letter but, importantly, *the spirit* of these new requirements. This will require businesses to address how to embed their values in their company strategy and their operational activity, and in the process shape their company culture in a more forward-looking and sustainable way.

The company's organisational design, and related executive objective and reward processes, need to address this if the company is to feel 'different' – and successfully recruit and retain new talent.

Each company needs to ultimately 'own' their own values if these are to resonate - internally and externally - and be meaningful. At the same time, if the public consider that the company has a strong public purpose, they may expect to see ethical standards/values that are common with other 'public service' providers. **The Committee on Standards in Public Life has found that public views of what constitute ethical standards are broadly in line with the Seven Principles of Public Life.**[34]

Given these fundamental points, and thinking about the particular characteristics of the energy and water sectors, companies may want to consider the following 'public service related values' and associated questions when working towards a 'Sustainable Licence to Operate:'

Accountability

- Who is the company accountable to for their decisions and actions on: strategy; operational performance; sustainability?[35]
- How in practice do the management team submit themselves to the independent challenge and scrutiny necessary to ensure accountability?[36]
- How is accountability for long-term outcomes and for 'systems' issues exercised in a meaningful way?
- How is accountability transmitted within the organisation, in terms of executive objectives and reward and organisational design?

Respect and integrity (treating others as you would like to be treated, doing what you say and holding yourself to consistent high standards)

- Are the company's *purpose* and *values* aligned and how are any conflicts between the two recognised and resolved by the board? [37]
- How does the board reassure itself that the company's actions and behaviours demonstrate respect and are within the spirit of its principles and values?[38]
- Are principles/values applied consistently and in step with changing societal expectations, including changes in management team or company ownership?

Openness and honesty

- Is the company transparent about all aspects of its performance?
- How simple and transparent is the company's ownership structure and business model – including on tax, dividend policy and executive pay?
- How does the company proactively seek out and face up to problems? How does it actively share lessons learnt, including what has worked/not worked?

Objectivity and collaboration - basing decisions on facts, understanding how the external environment/partner needs are changing, acting fairly towards these

- How does the company base its decisions on all the necessary evidence - including for social and environmental outcomes? How are the latter factored in to board decision-making?
- How does the company share information with other stakeholders to maximise the opportunities for collaboration and innovation?
- Do company's board/committees have the diverse skills and experience needed to provide an objective view of stakeholder needs/company performance?

Leadership[39]

- In practice, does the company develop a positive and ambitious vision and public purpose for its work *together with its stakeholders?*
- What does the Chair, board and management team do to set the tone from the top and promote good behaviour – (1) in the company and (2) for the sector? [40]
- What does the company do to nurture customer, community and stakeholder groups so they can play a more active role in developing/delivering services and does it use its consumer engagement/ challenge groups to test its engagement approach and strategy?

A clearly articulated **philosophy** may help electricity, gas and water companies embed their values more deeply. Companies in these sectors may be able to learn from work in the not-for-profit sector and from international government agencies (like the World Bank) where there is a strong drive to deliver public benefit. In delivering an essential service, former distinctions in the purpose and values of 'for-profit' and 'not-for-profit' organisations, may increasingly fall away.[41]

Many major NGOs and international agencies use '**Theories of Change'** to help guide their work.[42] These may provide new perspectives on how to navigate in a more nuanced and ambiguous landscape. As well as a strong outcome focus, 'back-casting' plays a key role in these theories. This is a planning method that starts with defining a desirable future and then works backwards to identify policies, programmes – and philosophies - that can connect the future to the present.[43]



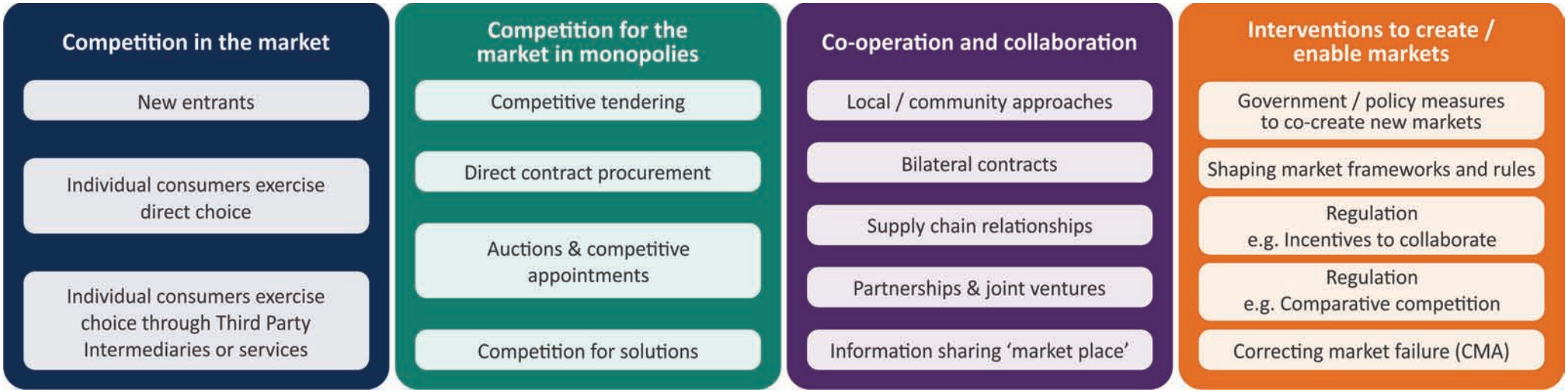
Appendix 2

Pillar 2: Approaches to making best use of different types of 'capital' - competition and collaboration

Definitions

Competition and collaboration in the energy and water sectors can take many forms, as illustrated in Figure 10. Given concerns around the market power of dominant players, much of the focus to date has been on competition *in* the market. However, competition *for* the market in monopolies is being increasingly seen as important. Until recently, approaches to collaboration - from supply chain relationships to interventions (whether by the state or other actors) to co-create new markets – have received less attention (particularly in energy). Collaboration and partnerships can mean different things in different contexts. They can range from working with an NGO to help deliver public interest outcomes for a particular activity/in a particular geography to partnering with others as part of a corporate strategy to increase market share or potentially to develop market position in a new market.

Figure 10: Different types of competitive and collaborative approaches in energy and water



Source: Sustainability First (adapted from New-Pin project)

The benefits and shortcomings of competitive and collaborative approaches

Some of the benefits and shortcomings of contestable and collaborative approaches are summarised in Table 4. Sustainability First's New-Pin project found that market led approaches can deliver many consumer-focused outcomes – including efficiency, value for money, service. With the right frameworks, competition can also lead to 'clean'/ sustainable and resilient services (in the short term). However, competition can struggle to deliver long-term resilience, place-based well-being and fairness (see Figure 2). Managed markets, collaboration and partnership work may be more effective at delivering social programmes and outcomes – as well as more 'citizen focused' outcomes – along with wider systems benefits (although these are sometimes only available if a 'value stacking' approach is taken). Collaboration may also lead to reputational benefits (eg the implicit endorsement of trusted third parties). But, collaboration can sometimes struggle to deliver more short-term customer-focused outcomes such as efficiency.

Table 4: High-level summary of some of the potential advantages and disadvantages of market led and collaborative approaches

	Market-led approaches	Collaborative approaches
Benefits	• Consumer and service focus • Innovation (but often from within the company or other commercial players) • Economy & efficiency • Price discovery • Dynamic, agile, flexible • Speedier decisions • Clear/limited objectives • Established cost/benefit analysis frameworks • Investors familiar with business models	• Citizen/region/community/bottom-up • Innovation (ideas from outside the company & from non-commercial players) • Effectiveness (greater focus on outcomes/wellbeing and stewardship of natural resources) • Unmet need discovery (eg for system) • Dynamic spill-over effects • Shared information/data • Build social networks /infrastructure • Integrated/circular approaches • Diversity of approaches/ideas • Reputational (if with trusted third parties)
Shortcomings	• Information asymmetries • Competitive behaviours may make relationships challenging • Race to bottom on price can undermine other outcomes / erode general trust in the market • Can encourage silo-based approach • Can marginalise societal groups with low buying power long-term interests (the environment) • Unintended consequences	• Collusion – inefficiency and poor consumer value • Blunts competitive edge • Multiple objectives can blur roles/responsibilities • Can sometimes lead to slow decision making • Investors may be unfamiliar with evolving business models & governance frameworks • Openness can expose corporate weakness • Lose company differentiation

Source: Sustainability First

Achieving a new balance of competitive and collaborative approaches is key for water and energy companies to deliver on their potential public purpose. It's not black and white with one set of approaches being 'good' and the other 'bad;' **a case by case approach – or a combination of approaches - is needed**. Ensuring that this looks at the respective benefits of a proposal through a consumer/citizen lens us important if the approach is to deliver in the 'messy' real world and not fail at the implementation stage.

Digitisation, AI, blockchain and robotics

The Fourth Industrial Revolution is rapidly reshaping what we regard as the public realm, blurring the lines between different spheres of activity[44] and leading to new ways of competing/ collaborating. Few areas are likely to be untouched by this tidal wave. However, in energy and water a greater understanding is needed of how desired outcomes from competition and collaboration translate in practice in this digital world into capital, operational, and cultural goals for (1) the company and (2) the sector to make best use of assets for an individual company's public purpose and to maximise whole-system value. For example, how to:

- ensure that the static nature of **institutional governance arrangements** (such as network codes) do not inhibit competition or collaboration elsewhere in the value chain (eg the supplier hub in energy or eco-system services in water);
- deliver more **personalised services** to ever demanding consumers/communities – but also address resulting unwinding of cross subsidies, differential pricing and those who are unwilling/unable to be early adopters of change;
- manage resilience given increasing **electricity dependency** of digitisation – including optimising demand reduction, demand management, and storage technology;
- deal with any **asset stranding** resulting from digitisation; and
- address any resulting disruption to **stressed natural systems**.

How to decide when to compete and when to collaborate - and who with

All companies have different forms of 'capital' to deploy. A '**gap analysis'** of the different types of 'capital' the company may currently have and may need in the future can help them identify where best for the future to compete and/or to work with others (see Diagram 1). In deciding whether to fill gaps/address weaknesses through greater collaboration, the company's corporate strategy, philosophy and leadership 'character' will come into play. Options may include: 'DIY'; reluctant partner; opportunistic partner; strategic partner; or co-creator.

Ownership may have some relevance here. Privately owned companies may be more comfortable with competition. Public/not for profit models may be more familiar with collaboration (but there is also competition – even if this is only comparative through league tables etc – here). Although identifying and delivering on common interests is the raison d'etre of co-operatives and mutuals, companies across the economy are now recognising the benefits of partnership working to deal with 'systems' issues and new **hybrid organisations** are emerging so distinctions around ownership are *in some ways* becoming somewhat dated.[45]

Companies are likely to seek to collaborate where there is a clear mutual interest. This is particularly so where they stand to learn from partnership working (hi-tech; culture change). Third parties may choose to partner with electricity, gas and water companies for a variety of reasons (achieve scale, access new funds, validation of products and services, make a social impact). Understanding the boundaries for collaboration and what anti-competitive behaviour might look like is important - companies may be encouraged to **partner outside the sector**. Companies will also wish to consider how their own values and philosophy align with partner organisations and any potential reputational issues.



Business models that may help make best use of different types of 'capital'

A company's business model will determine how it works to create, deliver and capture value and may help determine how it approaches issues of competition and collaboration. The IBE has noted that business models need to be consistent with purpose and values for statements on culture to be credible.[46] This is not a simple question of ownership.

As previously noted, digitisation is disrupting existing business models. In delivery of its public purpose, or in delivery of wider systems value, core business approaches may be called into question – including the role of subsidiaries or out-sourcing for customer-facing, social or environmental related work.

Other options, such as setting up a separate entity for certain activities (for example, as a Community Interest Company) and/or a non-regulated subsidiary has attractions, where the functions it fulfils are genuinely separable. However, there are risks that could potentially lead to this becoming a 'poor relation' to the parent, with a risk of under-investment if such a subsidiary



was seen as a 'necessary evil' – and not a new way of doing business and creating new value. It could also make it more challenging for the company to claim that it had a coherent philosophy or public purpose/systems value focused culture. Indeed, for 'big names,' the public may see the company as a single body and expect to see its vision and purpose embedded across the whole organisation. Disaggregation may also unpick systems benefits such as resilience.

Given the evolutionary stage of many new business approaches, there could be a good argument for an incumbent to find ways to firstly 'trial' these in an incubator or sand-box subsidiary/arms-length company before adopting them in the core business (although there may clearly be licence implications here).

Table 5 is a high-level snapshot of some contemporary business models. It asks how these might impact the drive to either compete or collaborate. Today's electricity, gas and water companies include and operate along-side these many different models. Energy retail has certainly had to challenge itself on different business approaches. For asset heavy energy and water network companies, it is currently less clear how the full range of different models will impact. What is certain, is that new ways of working are changing societal expectation about what is and isn't possible in terms of desired service delivery.

Table 5: Snapshot of the evolving world of business models: *possible* impacts on incentives for competition and collaboration

Business model ***Example***	**Associated funding model**	**Comments on competition and collaboration effects**
Regulated capital business *English water companies, energy networks*	Regulatory Asset Value	Dominant current business model for energy networks and water wholesalers. Competition for the market may be possible. May not encourage asset sharing but may get collaboration in specific areas if correctly incentivised
Output based regulation *Energy networks & water wholesalers / Gatwick Airport*	Company commitments to regulator to deliver binding outputs	Integrated and potentially circular business model where constructive engagement can help determine outputs. Competition for the market may be possible. May get collaboration on agreed outcomes – (eg community, local, fuel or water poverty)
Co-operatives, Community Benefit Societies *Brighton Energy Coop*	Members invest in assets, the Coop sells the energy and pays back member interest/capital	Social, lean and integrated local business model
Service business *Energy retailers, water business customer retailers*	Margins	Suitable where value is derived from people assets (skills, intellectual property etc). Incentives to compete
Service business - Community Interest Companies *Affordable Warmth Solutions*	Varies – contract management fees, additional funds (eg ECO)	Social and integrated business model. Leverages in partnerships to deliver wider public interest outcomes
Product as service *Zipcar, Kaer (Singapore)*	Renting, leasing assets	Potentially an integrated, circular, social and lean business model. Incentives to collaborate
Platform owner *Uber, Provenance*	Licencing, subscriptions	A lean and social (particularly if open source) business model where business builds and owns platform. Profit from monopoly platform – but strong incentives to collaborate with other parts of the value chain (drivers, customers).
Platform service business *Apple*	Fees for apps	A social and lean business model which encourages others to innovate. Strong incentives to collaborate – eg App developers
Layer player / multi-sided platform *Alibaba, Walt Disney*	Varies – could inclu. commission, subscriptions, advertising, service based etc	A lean social business model which adds new steps to existing value chain (eg user demand, ecosystem infrastructure, ecosystem platform, ecosystem contributor). 'Envelopment' may be anti-competitive
Business ecosystems services business *EBay, Philips Healthcare*	Fees, subscriptions	Funding comes from fees for connecting supply/demand (aggregators) or from creating the market place (orchestrators). Potentially lead to integrated, circular, social & lean business models. Strong incentives to collaborate

Note: Different business models are clearly not mutually exclusive

Source: Sustainability First: adapted from various sources including Volans,[47] Accenture,[48] the National Grid[49] and the World Bank[50]

Policy and regulatory frameworks for competition and collaboration

Policy and regulatory frameworks undoubtedly also shape company decisions on competing and collaboration. Therefore, framing these in a way to ensure focus on the full range of public interest outcomes and systems values is key. To date, these have predominantly prioritised competition-led approaches – to deliver efficiency – in the interests of individual customers - rather than incentivising partnership working for long-run societal benefit.

For the water and energy sectors, a sense of 'strategic direction' from policy and regulatory frameworks is perhaps clearer and more consistent for environmental issues (including from legislation on climate change, pollution standards and water quality etc) albeit that there are significant questions as to whether these go far enough (eg in air quality) and around how these will be dealt with post Brexit. There is a stated political wish to address fairness and social matters – for example via the energy price-cap, price controls for household water customers, targeted efficiency schemes such as the ECO and a strong regulatory focus on customer in vulnerable circumstances - but, these many initiatives have yet to be fully integrated into a long-term and strategic view that matches the reality of the many people that struggle to pay for their essential services.

Mariana Mazzucato's work on 'mission orientated innovation' in areas such as clean growth is relevant here. To achieve these public purpose missions, she has said that the view of the state needs to be revised from just correcting market failures to being itself entrepreneurial, co-creating and co-shaping markets, enabling policy makers and regulators to provide the right frameworks where sectors can work together to deliver multiple 'spill over' benefits.[51]

Others consider more focus is needed on competition. Dieter Helm has recently advocated a system operator approach in water similar to the ESO in energy, where increasing parts of a company's business are made contestable and system operators offer up the business plans to competitive tendering. Helm has stated, *'It is time for [water] regulation to move on and get attuned to the new world. System operators keep public the decisions that are for society to make about systems and leave the private sector in whatever ownership models it chooses to compete to deliver these public goods.'*[52]

This approach may potentially deliver benefits in terms of increased efficiency although in water, where there is currently no national grid and it is a 'heavy' good, much may depend on geography, resources etc for this be realised. However, in the absence of 'society' making active choices about systems – along with the distribution of risk and rewards – some of the knotty issues around public purpose in the sectors may persist.

In some respects, competition-led approaches may simply 'shift the problem round' - by introducing the risk that companies competing for major capital or operating contracts are insufficiently aligned with possible public purpose goals (including safety, resilience etc). Helm recognises that there would be a need for a 'fit and proper' test in the auctioning processes to avoid Carillion-type failures. More detail would be needed on what this test may entail to build confidence in this area. Recent corporate failings and problems with rail franchising – plus recent work by the Committee on Standards in Public Life (see box) and proposed reforms to the Public Services (Social Value Act) 2013[53]- point to the difficulties that may arise.

In the digital and technology worlds, the early mover advantage backed by significant venture capital funding is a significant factor in subsequent dominance. Across the globe, policy makers and regulators are struggling to understand what to do in terms of the competitive dynamics of multi-sided platforms and how to regulate a plethora of shifting business shapes.[54] For example, if regulators are reactive, accountability may come too late and be harder to enforce; or, if they focus on individual rights, social impacts may be over-looked.[55] At the same time, for GB electricity, gas and water companies, policy and regulatory frameworks were designed for an analogue age and may potentially 'get in the way' as they try to decide how best to compete/ collaborate for delivery of their wider societal purpose.

Looking beyond VFM – lessons from public service providers to government

The Committee on Standards in Public Life's recent report on public service providers concluded that all government commissioning departments *'must adopt a wider view of value for money, one that embeds ethical considerations at every level.'* It found that the lack of reach of the Freedom of Information Act into activities of public service providers is leading to a gap in access to company cultural and behavioural information, which makes it challenging for commissioners to perform 'ethical due diligence' tests prior to letting contracts. Commissioners are therefore encouraged to focus on efficiency and value for money in the narrow, cost-reduction sense of contract management. The Committee recommended public service providers must, at the point of commissioning, publish a 'statement of provider's intent' providing their plan for embedding a culture of high ethical standards in their service delivery.

Committee on Standards in Public Life, The continuing importance of ethical standards for public service providers, May 2018

In the current political environment and given the huge distractions of Brexit (which may mean that legislation in this area will be hamstrung by the requirement for a significant number of Brexit bills over the next few years) it may be challenging to get policy change which is future-focused and seeks to re-draw the boundaries for competition-led approaches and collaboration. This makes the need for company leadership more important. Companies across the energy and water sectors can lead by building a rigorous evidence-base to share with policy makers when the time is right.



Appendix 3

Pillar 3: Roles and responsibilities – Expectations and working with stakeholders on what is 'fair'

Current roles and responsibilities in regard to fairness

As electricity, gas and water companies provide essential services, to some extent fairness has always been an issue for them. Roles and responsibilities regarding certain aspects of fairness and the environment in the sectors are enshrined in primary legislation, regulation and a licensing framework and voluntary and statutory codes - as well as general company and other legislation (eg employment and tax law).

Customers in vulnerable circumstances Both Ofgem and Ofwat have a statutory duty to take account of the needs of certain vulnerable groups (and, for Ofwat, those not on mains water supply).[56] This is reflected in initiatives such as the requirement for a Priority Service Register, water efficiency advice, as well as cross-subsidies and social tariffs. For energy there are pre-pay meters and safeguard and standard variable tariff price-caps. The elderly, the sick and those on low incomes can also access additional assistance through industry and government schemes such as: the ECO, the Warm Home Discount; the Winter Fuel Payment; the Cold Weather Payment. And in water, some social tariffs;[57] and WaterSure.

Cross-subsidies Exist in both sectors, in part due to historic reasons and in part to address various social and environmental issues, including: green energy levies (paid at a common flat rate dependent on kWh usage, regardless of ability to pay); social schemes such as the ECO (where a fixed charge per customer is similarly recovered); water charges based on former rateable value of the property rather than actual water usage; partial roll out of water metering; existing customers paying for both past investment plus new infrastructure that future customers will benefit from; a tendency for existing customers and regulators to sometimes duck long term investment/capital maintenance, in terms of lower short term bills; and, more affluent early adopters of new technology (eg PV panels) benefiting whilst the less well-off may not access that new technology or benefit from any savings. Even when cross-subsidies are intended to protect a group of customers in vulnerable circumstances, they may entail moving costs to others who may equally struggle to pay.

An evolving flexible approach Regulators have recognised that the fast pace of technical and societal change means that roles and responsibilities – and approaches - need to evolve. The move to

Conduct/Principles Based Regulation, including Ofgem's new vulnerability principle for energy retail and amended fairness test, should help give energy retail companies flexibility to address these issues. [58] The work of the Water Industry Commission in Scotland on ethical regulation is another example of how regulation is evolving along these lines. Commitments to focus on regulatory **outcomes** for consumers in vulnerable circumstances in energy networks, is another step in this direction. The extent to which these steps provide a proactive and flexible framework for companies to operate in, or how Ofwat's approach to affordability in PR19 with its mix of metrics and principles[59] plays out in practice, remains to be seen.

Consumer focus Understanding that meaningful consumer engagement can help in decisions about what is fair has also grown over recent years. Increasing attention has been paid to regulatory requirements around enhanced stakeholder and customer engagement as a way of ensuring that consumer interests sit at the heart of regulated company decision-making. Ofwat and the water sector have led the way here with their provider focused Consumer Challenge Groups (CCGs) which in many cases have been seeking to

build a coherent picture between consumer, citizen and environmental interests. Ofgem is changing its approach for the RIIO 2 round of price controls for energy networks along these lines.

Changing expectations around roles and responsibilities in terms of fairness

Changing state / business relations There is an increasing expectation that large companies delivering essential services (water, energy, transport, financial services and communications etc) need to do more to demonstrate that are not only 'respected corporate citizens' meeting their obligations on issues such as taxation, and being good employers, but that they also show moral leadership in a time of exponential change. Consumer views on bottled water and the role water companies may play in dealing with plastic pollution is an example. If companies are not able to evidence what they are doing to help lead the way through some of the hard social and environmental problems that are shaping the systems in which they operate, they may see their reputations suffer and may have change thrust upon them. This risk is greatest when companies are thought to have responsibilities as stewards/custodians of key resources/assets.

Public frustration where companies act 'unfairly' can boil over - leading to ad hoc and potentially heavy-handed interventions that may bake in solutions to yesterday's problems and may not recognise the company's, sectors or wider 'system' needs. Such approaches can add inflexibility and make it harder for companies to respond in an agile way to disruption. Alternatively, lack of corporate leadership could lead to fundamental issues being put in the 'too difficult box' (eg major new investments), deferred or kicked down the road, potentially raising future costs or foreclosing future options.

This doesn't mean that water, electricity or gas companies should provide a blank cheque or open-ended commitment to deliver social and environmental outcomes on behalf of the state. However, recognising the extent of the problems faced by their key partners (seeing it 'through their eyes') and identifying **areas of mutual interest** where they can collaborate to deliver on common goals is likely to be increasingly important. This could, for example, include exploring with policy makers how strategic initiatives to tackle long-term affordability and fairness such as personal allowances [60] and Universal Basic Incomes could work in their own sectors. Care must be taken, however, to avoid 'mission creep' from which it may be difficult to retreat.

Desire for greater 'control' This can vary widely between (and within) groups including consumers (personalised services), citizens (democratisation), workers (ownership, new business models) and communities (eg place-based needs, going 'off-grid,' or pushing for higher protection of local natural resources etc). These trends don't necessarily all pull in the same direction and can lead to new questions of how to balance different interests in a fair way.

Shift from 'vulnerability' to 'fairness for all' Focusing on vulnerability alone is unlikely to be a sufficient response to future change. Discussions around the shift from outcomes which are 'optimally efficient' to those that are 'relatively efficient' are growing as market definitions blur. There is also widespread recognition that vulnerability isn't a static situation, but relative and dynamic[61] and that disruption may well give rise to new types of vulnerability (eg those without broadband etc). Indeed, the recent BEIS Consumer Green Paper emphasises 'fairness for all.' This implies a need to protect customers in vulnerable circumstances as well as others, whether engaged or not, at least to the extent of not unduly discriminating against them. Electricity, gas and water companies that want to demonstrate leadership may want to look beyond just minimising harm to identifying what to do differently to solve problems and release new sources of value for this wider range of consumers and stakeholders.

Move to service business This change in societal expectations is happening at the same time as energy and water companies move from being infrastructure or commodity providers to modern service businesses. In turn this means that consumers and communities are likely to play a more active role in offering flexibility to the energy and water systems. In addition, more consumers will expect ever more tailored services posing further new fairness challenges, and blockchain may undermine traditional intermediary models currently dominant in electricity, gas and water retail businesses. Companies may need difficult discussions across stakeholder groups as to how to balance individual interests - with common interests (however defined).

Cross sector approaches to dealing with fairness As essential service providers, water and energy companies

need to collaborate with each other (and policy makers, regulators and third sector bodies) and recognise the value of carefully managed data-sharing and support mechanisms to deliver a more effective and joined up service. These need to complement moves towards multi-utility and 'home' service packages. As such initiatives take off, and companies increasingly recognise that they can help empower consumers through smart data, roles and responsibilities for fairness are likely to evolve.

Engaging with consumers and wider stakeholders on 'Compacts' for fairness

Both company-led and regulatory-led consumer engagement activity have been extremely valuable in encouraging **cultural change** and a greater **consumer focus.** But, in terms of fairness, and on its own, engagement activity is unlikely to lead to a significant step change to shape roles and responsibilities. There are various reasons for this, albeit engagement activity in the sectors is rapidly evolving.

The role of most of the existing consumer and stakeholder engagement groups is advisory. Although their reputational impact may potentially be significant, they have limited power to influence strategic fairness agendas. Given most engagement bodies are provider focused, they are not set up to deal with some of the long-term, 'systems' and cross-sector issues that need to be considered when thinking about roles and responsibilities for delivering public purpose and systems value. A wide range of different 'voices' have become involved, but their remits mean that their main focus is on consumer and not wider public interest/environmental/ community views. In addition, discussions about issues of more strategic principle can be very technical, making it difficult for some interest groups to have a say. Without accompanying steps to **build capacity** and resource to enable a wider range of public interest actors to take part (such as local authorities and community schemes), it would be unsurprising if at best only the larger metro-regions actively engage in practice.

A step change in engagement approaches could drive greater fairness in the electricity, gas and water sectors. For more meaningful engagement in decisions around fairness, consumer, citizens and other stakeholders need a new framework that sets out the company commitment. This effectively would be a company '**Compact**' (agreement or 'contract') with stakeholders to set out the ways and means by which they can engage short and long-term. Stakeholders also need to be involved in company decisions on values - and how to deal with fairness between different actors. Provider-focused engagement can make this a challenge.

The approach to adopting such a Compact could take various forms. A Compact would be a fundamental element of a 'Sustainable Licence to Operate' and would be a voluntary commitment. If companies don't take this type of initiative, there is a risk that this sort of issue goes into a more formal and bureaucratic regulatory process, such as a code review or even a licence obligation. This may not be the best way forward as it could risk becoming a 'minimum' legal obligation upon the provider or a somewhat inflexible instrument. Consumers, citizens in general, environmental interests and communities affected by the commercial activities of the provider may not figure strongly in this equation (particularly If the company is head quartered overseas).

Whatever model was adopted, fairness has to be linked to robust governance and to be integrated into all aspects of the company's business. As the importance given to engagement increases, more formalised mechanisms such as citizen juries[62] may need to be adapted to maximise transparency and add more independence and rigour to the process.

Appendix 4

Pillar 4: Strategy and narratives – Conveying a positive, honest future roadmap for the company and the sector

Moving from reporting data to sharing narratives

As well as CSR reporting, there are many additional sector specific reporting mechanisms in energy and water. For example, the Ofwat Company Monitoring Framework[63], the RIIO 1 reporting requirements to Ofgem, or Ofgem guidance on energy supplier complaints data.[64] As noted under Pillar 1, there is also a developing body of corporate governance reporting requirements that require companies to explain in the Strategic Report section of their Annual Report how key provisions are met, such as Section 172 of the Companies Act 2006. This includes how they have engaged key social and environmental stakeholders such as their workforce in their activities.[65] Such initiatives should help support a shift from detailed data reporting to clearer company narratives.

To strengthen reputations and become more future-focused, companies are likely to want to go beyond these legal and regulatory reporting requirements. **Digitisation and AI** have the potential to revolutionise the way that regulators – and consumers – expect data to become available and analysed. Forward-looking companies are already working with stakeholders to ensure that in this data-rich world (including, potentially, real-time), more focus is placed on producing meaningful information of use to their different 'constituents' (eg local/national). If information feedback loops are used effectively, this can help build consumer trust and change behaviour to increase energy/water saving (eg competitions between streets or villages to be the most efficient).

It is vitally important to consider how narratives are developed between companies in a **sector**. This is the area that possibly needs the most attention. As systems issues become more important and reputational problems spill-over between businesses, far clearer joint narratives between companies are needed for systemic issues to be better understood and reported on (eg carbon footprint information from RIIO submissions). For these narratives to be credible, key metrics need agreeing – and must be comparable and consistent over time.

Engagement

Knowing who your audience is, what matters to them and what they want to see reported is an essential first step in developing a positive strategic narrative. This makes engaging internal and external stakeholders key, not only to shape the company's purpose and values in the first place but also to identify the metrics that would be meaningful and **relevant** for them in terms of assessing future performance. Stakeholders are likely to have views on the level of detail required (in some cases this may be nothing) and how information is best 'cut' to make it useful for them so that it is not aggregated to make it meaningless but presented in a way that they can relate to (eg at community or divisional level). Companies need to develop a view as to which stakeholders could potentially become 'third-party endorsers' and which may always be 'oppositional.'

Whilst companies may be familiar with engaging with investors and regulators in

this way, they have traditionally been less familiar in working with wider stakeholders to identify and shape performance metrics (although this is starting to change, particularly in water). Engagement can also help get the **right language, tone and timing** in company communications. Although the timing of Annual Reports and Accounts and regulatory business plan submissions may fit with the interests of some stakeholders, it may be 'out of step' with the needs/expectations of others. Companies can clearly only find this out by asking the relevant parties and seeking to understand their capacity to absorb/respond to at a given time.

Positive future road maps

Articulating a clear, ambitious and honest vision plus direction of travel is important for a company to inspire and motivate its workforce, contractors and collaborators/partners – as well as its external stakeholders. The performance metrics that feed into this bigger picture, need to hang together and map how the company is reaching its destination. Aligning this with the company's stated purpose, values and responsibilities in a **coherent way** to avoid inconsistencies or contradictions is also vital to build trust.

Just as the company's strategic narrative needs to be forward looking so too do some of the performance metrics that sit under this. This means getting the right balance between **leading/predictive** and lagging/historic indicators. Unless the company takes this long-term look, it can be difficult to identify trends, understand how risks may evolve and to take the necessary mitigating actions. As the energy and water sectors go through transformational change, metrics also need to capture this and be regularly challenged to help ensure they are still relevant (eg demand side metrics).



Integrated reporting

Processes need to be in place that enable the company to go beyond reporting numerical data, often focused on financials and outputs (eg length or pipes or wires) to also include information on performance on delivering wider social and environmental outcomes and the way in which these are delivered (the company's behaviours and culture).

Whatever internal performance metrics a company uses to monitor its performance, these need to be holistic, integrated and evaluated. Pressure for change in this area is coming from the investment community. An example of this is the International Integrated Reporting Guiding Principles, a highly respected framework, that aims to:

- Improve the quality of information available to providers of financial capital;
- Promote a more cohesive/efficient approach to reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of the company to create value over time;
- Enhance accountability and stewardship for the broad base of capitals identified in Diagram 1 and promote understanding of their interdependencies; and
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term. [66]

New metrics need to be considered alongside current ones and integrated into a bigger picture. Caution is needed to avoid 'cherry picking' or selecting indicators to reflect a 'desired outcome'.

Measuring and reporting on ethics and culture

To give a clear overall picture of company performance and its culture, the IBE suggests that a triangulation of data is needed using a basket/dashboard of standardised and bespoke measures which, '*may comprise a limited number of indicators that can be tracked closely and are chosen to reflect the company's values, business model and key stakeholder relationships*.' A traffic light system could give early warning and enable pre-emptive action to be taken.[67] Many companies are already collecting significant information in this area through mechanisms like Yammer 'YamJams'.

Cultural change in water and energy must come from the top and permeate the full organisation. The chair, board and chief executive must lead and demonstrate that the organisation is committed to its public purpose and values. This is particularly important for commitments to social and environmental issues and ethics where employees and stakeholders may have different views and/or quickly sense any mismatch between words and actions. Ultimately, the CEO/Chair need to 'tell the company and sector story' in a **personal and credible** manner.

The way in which the corporate values and philosophy of the company are distilled down, put into action, monitored through the organisation and supply chain, and the way that data/information arising from this is treated and thereafter acted upon are crucial. The right information and frequency of reports to the board are also clear indicators on what matters to the company and how much value they attribute to aspects of the business. Key measures to consider are likely to include: how the company delivers on its public purpose and values; how it rewards and reports on employee contribution to delivery; and what weight this is given in the appraisal process; and how it captures information on customer views and environmental impacts. Social media platforms such as Glass Door and Trust Pilot are providing a wealth of new sources of information in these areas [68] (although the veracity of some sources of data may need to be treated with caution).

Reporting frameworks, independent assurance mechanisms and auditing / certification schemes

These can help ensure that new developments in reporting aren't just another way of letting companies 'set and mark their own homework.' For example, EU Directive 2014/95[69] requires companies with more than 500 employees to report on five non-financial aspects, including social responsibility and treatment of employees and board diversity. Another good example is the German Sustainability Code.[70] This takes a holistic view of sustainability and provides companies with a framework of criteria to report against.

Alternatives to relying upon internal assured data as evidence, could be through independent research and independent audit/certification services. To maximise effectiveness, such bodies need to have a good understanding of relevant social and environmental issues (along with associated costs).

Network companies that do not generally speak or have a direct connection with the end user of their product can face specific challenges. Reporting on the frequency, level and outcome of proactive engagement with wider civil society could be one way to address this. Peer review can also fill this gap. This could help in that it would provide a professional, knowledgeable insight, rather than a lay perspective. Independently run benchmarking groups could help ensure reporting was robust and objective.

Accreditation by third parties can also be helpful, albeit sometimes high accreditations might sit at odds with certain media or other coverage of the same company. There are a number of organisations that accredit, have league tables or make awards for social and environmental sustainability. Some accreditation schemes are well-known and highly-regarded. [71] Others may draw on unaudited or internal-only company data - which perhaps calls at least some schemes into question.

Policy and regulatory narratives

Just as companies need to pay attention to their own and their sector narratives, so too do policy makers and regulators. These need to clearly set out their mission orientated objectives and the public interest outcomes that they want to see delivered. Company performance needs to be assessed within this framework to provide context and perspective.

Policy and regulatory narratives – and the tone adopted - can play a key role in 'anchoring' and 'framing' stakeholder scrutiny of company/sector performance. If the focal points for these narratives are not aligned with key objectives and outcomes, it can act as a distraction from other priorities and may potentially lead to a more defensive culture in companies where they may not feel able to share the lessons from failure or reach out to form new partnerships.



Glossary

Note: this glossary consists of the '**working definitions'** that will be used in the Fair for the Future project. We will revise these during the project.

- Business model: how the company works to create, deliver and capture value and earn its profit
- Environmental outcomes in the long-term public interest include: clean; sustainable; low carbon; and healthy (for consumers and for the environment itself). Environmental needs include biodiversity, habitat protection, eco-system integrity, air quality and working within systems limits.
- Fairness: impartial treatment or behaviour towards people (within and between generations) and different stakeholder groups (including the environment) without favouritism or discrimination or in a way that is right or reasonable. It is a multi-dimensional, relational political and moral concept. Outcomes, processes /behaviours, voice, deals, opportunities and explanations are all important dimensions of fairness
- Long-term public interest in energy and water: the aggregate well-being of the general public, both short and long-term. It comprises the combined interests of consumers, citizens, the environment and investors, for both today and tomorrow
- Long-term public interest outcomes in energy and water: the combination of consumer outcomes (value for money and quality service) and 'citizen' outcomes (clean/sustainable services, resilience, place-based well-being and fairness)
- Mission: what business the organisation is in and its overarching goals now and for the future for the sector, system, society etc
- Philosophy: theory or attitude that acts as a guiding principle for behaviour
- Purpose: what company is there to do and the impact that they want to make on their various stakeholders
- Social compact: accountability bargains between companies and citizens
- Social contract: voluntary agreement among individuals to secure mutual protection and welfare and to regulate the relations among its members
- Social licence to operate: on-going to operate within a local community
- **Sustainable Licence to Operate: on-going endorsement to operate within society and the energy/water system to deliver long-term public interest outcomes**
- Systems:
  - Energy: The 'whole energy system' covers production to the end consumer/prosumer;
  - Water: The water system extends from catchment management via the consumer to waste water and ultimately re-use (a circular system);
  - Environment: Ecosystems (including bio-diversity, air/water quality etc)
  - Society: Social systems and social infrastructure;
  - Technology: Ecosystems cover the Internet of Things; and
  - Business: Ecosystems are dynamic and 'co-evolving' networks of interlinked companies and supply chains.
- Values: a guide to principles or standards of behaviour
- Vision: targets and ambition

Footnotes

[1] Excludes energy generation
[2] Ofgem, Standard Variable Tariff League Table, 2017
[3] European Commission, Consumer Market Scoreboard, 2016
[4] Ofgem, Customer Satisfaction with energy supplier complaints handling, 2016
[5] See, for example, Financial Times, Water Companies Warned on Failure to Reduce Pollution Incidents, February 2018
[6] Sustainability First, Looking to the long-term: hearing the public interest voice in energy and water, February 2018
[7] IPCC, Global warming of 1.5°C, October 2018
[8] See, for example, Sustainability First, Regulation and public interest outcomes: moving beyond compliance and towards a 'Sustainable Licence to Operate' for a disrupted world, June 2018
[9] At least 12 of the 17 SDGs are relevant to the energy and water sectors including: no poverty; good health and well-being; clean water and sanitation; affordable and clean energy; and climate action.
[10] Volans, Breakthrough Business Models, 2016
[11] June Sekera, Seminar at UCL on Public Economy, Public Goods and Public Value, December 2017
[12] For example, can an energy supplier's wholesale hedging strategies be efficient with the market effectively moving in an easily anticipated way driven by a price cap? Will fuel poor consumers that had shopped around now see their prices increase?
[13] JRF, UK Poverty 2017, December 2017
[14] The Labour Party, Consultation on Democratic Public Ownership, September 2018
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Address: c/o IEEP, 11 Belgrave Road, 3rd Floor, London, SW1V 1RB

WWW sustainabilityFirst.org.uk

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If you would like more information about the Fair for the Future project, please contact

sharon.darcy@sustainabilityfirst.org.uk

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