Fairness in utilities: What are the implications of public purpose for companies, policy makers & regulators?

Conference, 30th March 2021: Summary

The video recording of the conference can be found here

Overview

There is a growing recognition that a focus on corporate purpose can align government, company, investor and other stakeholder interests around long-term goals such as net zero and help ensure that these are delivered in a fair way. On 30th March Sustainability First hosted its 'Fairness in utilities' conference. The culmination of three years research through it's Fair for the Future Project, the conference explored what the purpose agenda means for both companies and government in sectors such as energy, water and communications.

Participants heard how a focus on corporate purpose on all sides can help ensure utilities earn profits from solving problems, not creating them. Panel members discussed the practical steps that can be taken to get public value adopted and noted that purposeful regulation is already being carried out, with some considering that this has been a game changer in Scotland.

Speakers demonstrated the need for a defined purpose in business. There was widespread agreement that now is the time to reset the system and that there is a need for new policy and regulatory approaches on long-term issues to protect the interests of future generations. Participants discussed how the changes outlined were not a leap in the dark; some have already been put into practice. Action is needed not theorising.

There was wide agreement that regulators should concentrate on what only they can do, making room for regional and local actors to grow, and the importance of community involvement. There was consensus that focusing on public purpose does provide a way forward in dealing with disruption. And a widespread view that greater collaboration between companies and regulators would be beneficial in dealing with difficult issues, whilst accepting that independent regulators will continue to have a clear role in terms of monopoly activities. There was support for common regulatory duties and cross-sector Strategic Policy Statements approaches to ensure greater join-up and people centred approaches.

The suggestion that 'campfire' discussions between policy makers, regulators, companies, investors and civil society groups are needed to build trust, work through trade-offs and help ensure long-term interests aren't kicked into the long grass resonated with nearly all the speakers. It's clearly time to come together and gather round the fire.

Welcome and opening remarks: Phil Barton, Chair, Sustainability First

Phil welcomed everyone to the conference and noted that it was not Chatham House.

Context and overview: Sharon Darcy, Director, Sustainability First

Sharon set out the specific features in utilities that make fairness in sectors such as energy, water and communications vital. She outlined the changing context in the sectors, including environmental, social and technological factors, and highlighted that we are in a decisive decade for both climate and fairness. She then set out how Sustainability First's major Fair for the Future Project had addressed the issue of corporate purpose, and what this means for companies and for policy makers and regulators.

Key-note address: Professor Colin Mayer, the Saïd Business School

> *"Sustainability First's report makes a powerful case why corporate purpose is particularly important in utilities and provides a tremendous framework in which to promote the creation of purposeful utilities and purposeful regulation."*

Professor Mayer has led much of the international thinking on purpose. In his opening key-note address he outlined how the current policy and regulatory system introduces a conflict between profits and regulation. A conflict which can be expensive and inefficient and is not conducive to a utility system that promotes long-term wellbeing of customers and the environment.

> *"A focus on corporate purpose on all sides can help ensure utilities earn profits from solving problems, not creating them."*

Colin argued that purposeful regulation is not just about the 'rules of the game' and their enforcement but also encouraging an alignment between the purpose of public utilities and what their customers, societies and environment are expecting and hoping from them. Public engagement is needed to identify what this looks like and to inform companies about the wellbeing and welfare of their stakeholders and whether customers believe what they are doing.

Regulation should encourage the delivery of purpose over the long -term, and position 5 year periodic reviews within longer-term strategies which promote intergenerational societal benefits. Colin explained that the partnership between regulators and companies that is needed to achieve this is not regulatory capture. Rather, company boards, investors and regulators need to determine how they view their roles and how these complement each other. Colin set out **six ways regulators can work with companies to put purpose front and centre** and ensure that they are not using this as a smokescreen to hide excess profits:

1. Ensure corporate purposes are determined through rigorous dialogue and consultation with stakeholders;
2. Allow appropriate ownership and governance arrangements for committing to and embedding purpose in organisations;
3. Ensure alignment between purpose, values and culture of companies;

4. Develop appropriate ways to measure companies in terms of purpose;
5. Ensure companies are on target to deliver their purpose; and
6. Put in place error correction mechanisms to put companies back on track when they are not delivering on their purpose.

Panel 1: what companies can do to put purpose into action and what regulation can do to help or hinder this process

Dame Polly Courtice of the Cambridge Institute for Sustainability Leadership (CISL), and Non-Executive Director of Anglian Water, started the discussion by noting why it is critical that we do things differently now. Before the next water price control (PR24) begins in earnest, Polly highlighted the opportunity to make a fundamental shift; to step back, strip back complexity and develop regulation in a collaborative manner. On questioning, she explained that although government is responsible for outcomes, and regulators for helping companies get there, a new mindset is needed to get to the destination in the least confrontational way.

> *"Although we all know where technical responsibilities lie, how we get there is through much greater collaboration and cocreation."*

Emphasising how a focus on purpose can build trust, she described Anglian Water's experience. Strong governance in the board room was key, to ensure this was owned and driven from the top, along with developing an evidence base to point to, ideally assessed by a third party. To this end, Anglian have been working with BSI / CISL to develop a 'Publicly Available Specification' which sets out the shared characteristics necessary to define sustainability, leadership and purpose.

Polly also pointed to the importance of Anglian's co-creating its social contract with its customers, to help get alignment between stakeholders in the region and to explore in detail what role customers can play. The company's work in Wisbech was cited as an example of where grassroots community work has spread from water resources to the development of long-term social and environmental value creation.

Sul Alli, Director of Strategy and Customer Services at UKPN, spoke next. Sul outlined how UKPN had undergone a transformation before purpose came in vogue – based on conversations with employees, regulator and customers on what its purpose was. This included: being an employer of choice; a respected and trusted corporate citizen; and being sustainably cost efficient. To make this vision practical and tangible, and to motivate and drive behaviours, Sul emphasised the importance of setting targets and metrics so every member of the team can say how they contribute to the vision.

Looking forward, he explained how, given that future decarbonisation is going to be far more intrusive than to date, UKPN has revisited its purpose in the context of net zero; to help ensure the company brings its customers with them and works alongside an eco-system of organisations to help customers make the transition. Understanding what may erode consumer trust in the future – and how this might be different to the past – has been

key to this process. This requires the company being inquisitive and curious about what is and will be impacting customers.

Sul said that regulation should get out of the way to allow companies to work with customers and communities to solve problems. Where this can't happen, regulation should be a 'force multiplier' for change.

> *"Regulators and companies should lean in, sit around those campfires that haven't been around before to understand the problem better and put solutions forward."*

Rachel McEwan, Chief Sustainability Officer at SSE, completed the first panel. Rachel explained how a focus on purpose is integral to SSE's strategy and something they considered in 2018 when they were carrying out a strategy and operating model review;

> *"Social and environmental risks aren't just risks to be managed, they are opportunities to create social and environmental value."*

Using the just transition as an example, Rachel explained how SSE's November 2020 Just Transition Strategy looked at the issue from the perspective of the fair distribution of climate goods (new skills and jobs) and climate bads (prices, bills, lost livelihoods). This entailed making commitments about the nature of new employment created standards in the supply chain etc and adopting principles such as consultation with trade unions when high carbon plants needed to be closed permanently. She noted how the company was encouraged by enlightened investors – particularly RLAM – to ensure social injustice doesn't prevent the move to net zero.

The panel went on to discuss how to 'lock in' purpose so that the focus on this would remain regardless of changes in management teams and investors. Polly explained that Anglian's changes to their Memorandum and Articles of Association essentially just codified what had been in the culture and values of the company for a long time. However, they recognised that people need to be able to see this in a formal way and treating this as a whole sustainability package also consolidated the approach and helped demonstrate why it was important, including for employees.

Sul considered that leadership was key here. Good leaders want to leave the organisation in a better shape than when they inherited it; this is the definition of stewardship.

> *"Leadership is more important than changing Articles of Association. At the end of the day, leaders cast a shadow – if that shadow is a poor one, it would be amazing for the organisation to do well."*

He also pointed to the need to create a culture where people feel comfortable in challenging and are curious about what is going on beyond their team, directorate etc. This will help maintain a positive culture once leaders go.

SSE has used frameworks to prove that they are putting purpose into practice. The UN Sustainable Development Goals (SDGs) have been crucial to help them 'bake' purpose into

their structures through incentive structures, linking them to executive remuneration etc and enabling them to use the machinery of the organisation (RemCo etc) to track performance and enable accountability to all stakeholders.

The need for accountability to the full range of stakeholders, including those who may struggle to pay or are in vulnerable situations, was raised in the questions. Polly explained how regular meetings between board members and stakeholders etc could help, along with developing systematic mechanisms to help those that can't afford to pay. Sul said that triangulating engagement approaches could help ensure customer needs now and for future are at the heart of the business. Discussing broader issues with stakeholders had helped the company identify who they need to partner with in the next phase of decarbonisation.

Keynote address: Minister for Business, Energy and Clean Growth, Anne-Marie Trevelyan

> *"Sustainability First's thought-provoking report is an important contribution to the public conversation at an important moment for country and climate.*
>
> *I agree with the report's key message that regulators and utilities have a crucial role to play in achieving net zero, social fairness and many other public goods. If the Covid pandemic taught us anything, it is that society expects all of its constituencies to do their bit in the public interest. It is the proper role of Government to encourage and enable this to the full extent."*

The Minister said that the Energy White Paper provides context and the clarity different actors need to drive decarbonisation and deliver value for consumers and noted that the call for evidence on fairness in the energy system was an important part of this. She went on to say that Government can do more to foster strategic co-ordination and expertise sharing across regulators, including developing 'a whole consumer perspective to ensure a better and fairer outcome for all consumers and especially for the most vulnerable.' Coherent and consistent regulatory duties across sectors, covering price, quality, resilience and environmental sustainability, should help in this regard and a future policy paper would explore pathways to greater collaboration, including weighing up the merits of a cross sector Strategic Policy Statement, with long term objectives aligned with government objectives and time horizons.

> *"For a fair transition Government and regulators must work together to achieve net zero and advance the cause of fairness in society. However, collaboration mustn't compromise independent utilities regulation."*

Regulation for the Future: Martin Hurst, Associate, Sustainability First

Martin took the audience through the conclusions from our latest major report on Regulation for the Future. He outlined the positive regulatory developments to date in terms of addressing purpose and public value and set out how regulation needs to shift its focus going forward so that regulators concentrate on what only they can do. He then explored how the government's role also needs to change before sharing the report's recommendations on how to get a better focus on long-term issues.

Panel 2: the implications of purpose from a regulatory, government and investor perspective

Rachel Fletcher, in her penultimate day as **CEO of Ofwat**, opened the panel. Rachel said that she was more optimistic about the situation in terms of purpose in the water sector and the progress that has been made (including the sector's Public Interest Commitment to net zero by 2030). Through Ofwat's raising expectations about the public value of water companies, it has improved trust in the industry and greater alignment between policy makers and water companies in terms of vision, putting it in a better place to address industry challenges for future generations.

> *"Ofwat's requiring company boards to set a purpose has embedded the idea the board isn't just there to serve shareholder needs. It has provided clarity that the 'gold standard' is no longer just compliance with regulation."*

Rachel went on to differentiate between Ofwat's roles in: creating the conditions to create greatest possible value for society and giving companies space to take ownership of this; and the need to continue to protect customers when they can't vote with their feet. This entails difficult conversations around efficiency.

> *"There's a role for collaboration and campfires but conversations with the regulator can't be limited to this. We need an outcomes-based regime. How this evolves will entail a degree of mess, learning and discovery. There is scope for win-wins but where this isn't possible, we need to grapple with difficult issues."*

Giles Stevens, Director of Policy at the National Infrastructure Commission, spoke next. Giles summarised some of the key findings from the Commission's 2019 regulation study which included the loss of public confidence in many utility companies. The Commission stopped short of mandating a social contract. Giles agreed that government needs to set direction of what they want from the sectors. Regulator duties should reflect this direction and a duty to co-ordinate was needed amongst regulators.

> *"Strategic Policy Statements can help expose and decide on trade-offs. We need a departure from the current 5-year settlements. Greater competition for strategic enhancements, including design, build and operation of assets, can help."*

Lawrence Slade, CEO of the Global Infrastructure Investors Association (GIIA), spoke next. Welcoming Sustainability First's report.

> *"Conversations in the last year have been invaluable in opening up this discussion. Partnerships and collaboration are critical; we need to work together."*

Describing how the 'pendulum' had been swinging constantly between returns to investors and costs to consumers, he pointed to the need for a fair mid-point. To get this, Lawrence considered that more discussion was needed around Environmental and Social issues in ESG - 'lets have a debate around that social contract' – and the value this can bring to

communities. He noted that this debate can only happen with clear direction and policy frameworks from government as infrastructure plays between multiple terms; 'we need more campfire discussions.'

How to get co-ordination across sectors was then discussed. Giles highlighted the need to avoid contradictory regulation, to focus on more efficient outcomes and to develop an all customer view that takes account of distributional impacts. He said that the UKRN needed 'more bite' and noted that in the past, some regulators had taken a more proactive approach to coordination than others.

> *"A coordination duty will help stop back-sliding, but it will only work if duties are the same."*

Giles then pointed out the need to ask whether there are then some duties that may need to be taken away.

> *"The more duties you add, the clearer government needs to be on trade-offs, particularly when there are distributional questions."*

A discussion of what can happen outside of the price control followed. Rachel noted that very little in the price control goes directly to social issues.

> *"There may be a real opportunity for regulators and companies to improve issues around inclusion, this can happen outside of the price control. Regulators can't be schizophrenic. They need to use the right tools at the right time to achieve the right goal – sometimes they need to be prescriptive, at others they need other tools. People need to get comfortable with regulators using different tools at different speeds."*

On long-termism, Rachel noted that there is already a lot of this in the water sector (WRMP. Etc).

> *"What's missing is lots of statutory planning requirements which together don't add up to a holistic plan. Companies need to ask themselves what their holistic plan is. There is a need to grapple with the sequencing of some of the investment needs - eg investment for resources, growth, lead etc – that could help with public acceptability."*

Giles noted that the NIC is already a voice for the long-term. However, he noted that:

> *"Government needs its own long-term vision."*

The discussion moved on to the balance between regional/local and national regulation. Giles considered that the issue of regional imbalances was important. The Commission has just started a towns study which begins to explore this. Rachel noted that Wales now have local / regional plans for environmental improvement; 'how far should welsh companies have engaged with these and be supporting them?'

Is there one thing government could do to move the agenda forward?

- Giles *'the forthcoming policy paper needs to be clear and set clear foundations for the long-term.'*

- Lawrence *'the need to update Strategic Policy Statements and for government to give a long-term commitment.'*

- Rachel *'firm long-term goals and working across departments where goals overlap.*'

Closing remarks: David Sigsworth, Sustainability First Trustee

David pulled together the main themes from the conference and emphasised that a greater focus on purpose isn't a leap in the dark; there is much practical experience to build on. However, the need for practical action is now.

Next steps: Sharon Darcy

Sharon outlined how Sustainability First will be taking forward this work in a '**Fair for the Future Project Phase 2**' and in a new '**Sustainability Principles Project**.' She invited people to get in touch if they were interested in partnering with Sustainability First in this work.

She ended the conference by thanking the speakers, panellists and participants, the Sustainability First team and the Fair for the Future Project sponsors.