Fair for the Future:

Delivering on fairness and the environment
An agenda for responsible business in UK regulated utilities
Mid-way report

January 2020

Sustainability *first*

> Regulated utilities such as energy and water are essential services, part of our critical national infrastructure and deliver wider public value. How they are built and provided and how they are operated and used can have a significant impact on the climate crisis and wider social, economic and environmental sustainability – and whether companies are trusted. To meet net zero in a fair way will require systems-level change. Utilities are very much in the front line in terms of delivering the transition. Responsible businesses must play a key role but they can't do this alone. Policy and regulation also need to be redesigned. The Fair for the Future project is systematically charting a way to frame these complex and inter-related outcomes.

What is the Fair for the Future project?

- The Fair for the Future Project aims to help regulated public utilities address the politics of fairness and the environment.
- Established by independent think tank and charity Sustainability First in 2018, it is a three-year project and runs to early 2021.
- The project is at the half-way point. To date it has focused firmly on the energy and water sectors. However, its conclusions are relevant to the wider regulated utility sectors.
- It has three workstreams and aims to:
  1. Develop and prove the concept of a 'Sustainable Licence to Operate';
  2. Deliver fairer social and environmental outcomes through a deeper understanding of political uncertainty and regulatory risk; and
  3. Identify what a 'Sustainable Licence to Operate' means for reform of policy and regulatory frameworks.

Mid-way report - overview

This mid-way report updates on the Fair for the Future Project. First and foremost, it is addressed to company boards and senior managements who must lead this change. It is also addressed to key stakeholders who must shape the wider environment in which this change occurs. This includes investors, regulators, policy makers, politicians, think-tanks, civil society groups, and those with a broader interest in regulation and governance.

This document pulls together the Fair for the Future Project's key findings so far and sets out:

- The disruption and challenges for the utility sectors in 2020 and beyond;
- What our 'Sustainable Licence to Operate' looks like so far;
- Early findings on current good practice by responsible utility companies;
- Initial conclusions on the evolving political and regulatory risk landscape – and the particular challenge in defining, measuring and demonstrating fair outcomes; and
- Our initial thoughts on how a 'Sustainable Licence to Operate' should impact future approaches to policy and regulation.

The Fair for the Future project is grounded in an extensive research programme. This is summarised at the end of the report – along with a summary of material published so far. We also flag our next steps for the project in 2020, when we will look in-depth at the political and regulatory change needed to formulate the 'right' frameworks and social, environmental and cultural metrics. These will be essential to assure stakeholders that companies are delivering on promised outcomes and are acting fairly and responsibly.

Disruption and challenges for the utility sectors in 2020 and beyond

Extent of disruption: Utilities have always experienced change and adapted to it. However, the multi-dimensional nature of environmental, social and technological change – and the pace of change experienced through non-stop social media in a post-truth world and in an era of 'brutal' politics – makes current challenges and uncertainties extremely complex. There is of course a spectrum, with the communications sector and energy retail perhaps at one extreme experiencing the most disruption and wastewater at the other. Nevertheless, silos and boundaries are being challenged at a rate previously not seen and business as usual is no longer an option. This is the new normal for utilities. Millennials may be more comfortable in this world than many senior decision-makers.

Drivers for change: developments in 2019 and agenda for 2020 and beyond: The PR19 and RIIO2 price control reviews for the water and energy networks, coupled with major political uncertainty, provide the immediate context. But 2019 has also been a seismic year for fairness and for responsible business with many other significant issues on the table.

- **Government's commitment to net zero by 2050** (Scotland by 2045) – With the UK hosting the UN Climate Change Summit in Glasgow (COP26) in November 2020, the focus on the climate crisis and mitigation is only going to get more intense. The speed and pathways to change, who pays and how to ensure a fair transition will be hotly contested in the years to come – particularly in the energy sector – although electricity is often an enabler to wider decarbonisation (e.g. of transport).
- **Adaptation to climate change** – In both energy and to a lesser extent water, less attention has been paid to climate adaptation (e.g. flood preparedness prior to the Yorkshire floods) than mitigation.

These two aspects of climate change need to be seen in the round; this matters as it goes to the heart of questions of strategic investment ahead of need and how risks and rewards are shared between generations.

- **Wider environmental challenges** – The focus on the climate crisis has meant less debate around natural environment issues (with the exception of plastics) such as biodiversity, which can have material impacts, particularly in the water sector. The UK's legislative redesign of environmental protection post-Brexit, coupled with the UN Biodiversity Conference in October 2020, will bring these issues to the fore.
- **The deregulation–nationalisation spectrum, trust and a democratic deficit** – Views are increasingly polarised – although both sides appear more comfortable with government intervention in matters hitherto left to economic regulation. Fundamentally both standpoints have a concern about fair outcomes and the real or perceived lack of legitimacy in established decision-making processes (in companies, regulators and policy makers). 'Contagion' from untrustworthy practice within and between sectors and institutions can be difficult to distance a company or an organisation from, and views about what is an essential service (e.g. broadband and energy retail) are evolving.
- **Corporate purpose** – Increased global interest in responsible and purposeful business needs to overcome the concern that this isn't just a new form of corporate social responsibility, and therefore 'at the margin'. Regulated utilities that deliver a public function and whose assets are a 'public good' are at the forefront of this debate and will have higher 'hurdles' to meet than other types of corporation. How the responsible business agenda shapes core activity in the utilities will be key.
- **Technology and business models** – AI, block-chain and big data are already reshaping utility business models and incumbents are struggling to catch-up – or are 'not allowed to play'. There are clearly tensions, particularly in energy, between how tech enables beneficial bottom-up and decentralised models of service delivery that help unleash the demand side and the implications this may have for the cross subsidies that have traditionally protected different groups of customers. It can also impact the economies of scale that may be important in the drive to net zero and asset stranding – with associated implications for intra- and inter-generational fairness. We need to understand both how to incentivise necessary innovation associated with basic utility modernisation and how to deliver the strategic innovation necessary for truly transformational outcomes. Regulatory models, and in particular government policy, are struggling to keep pace – particularly in terms of platform businesses.

Against this deeply disrupted backdrop, turning **'talk' into action** presents a major challenge for all actors. It is where we start to see a 'Sustainable Licence to Operate' playing a truly change-making role.

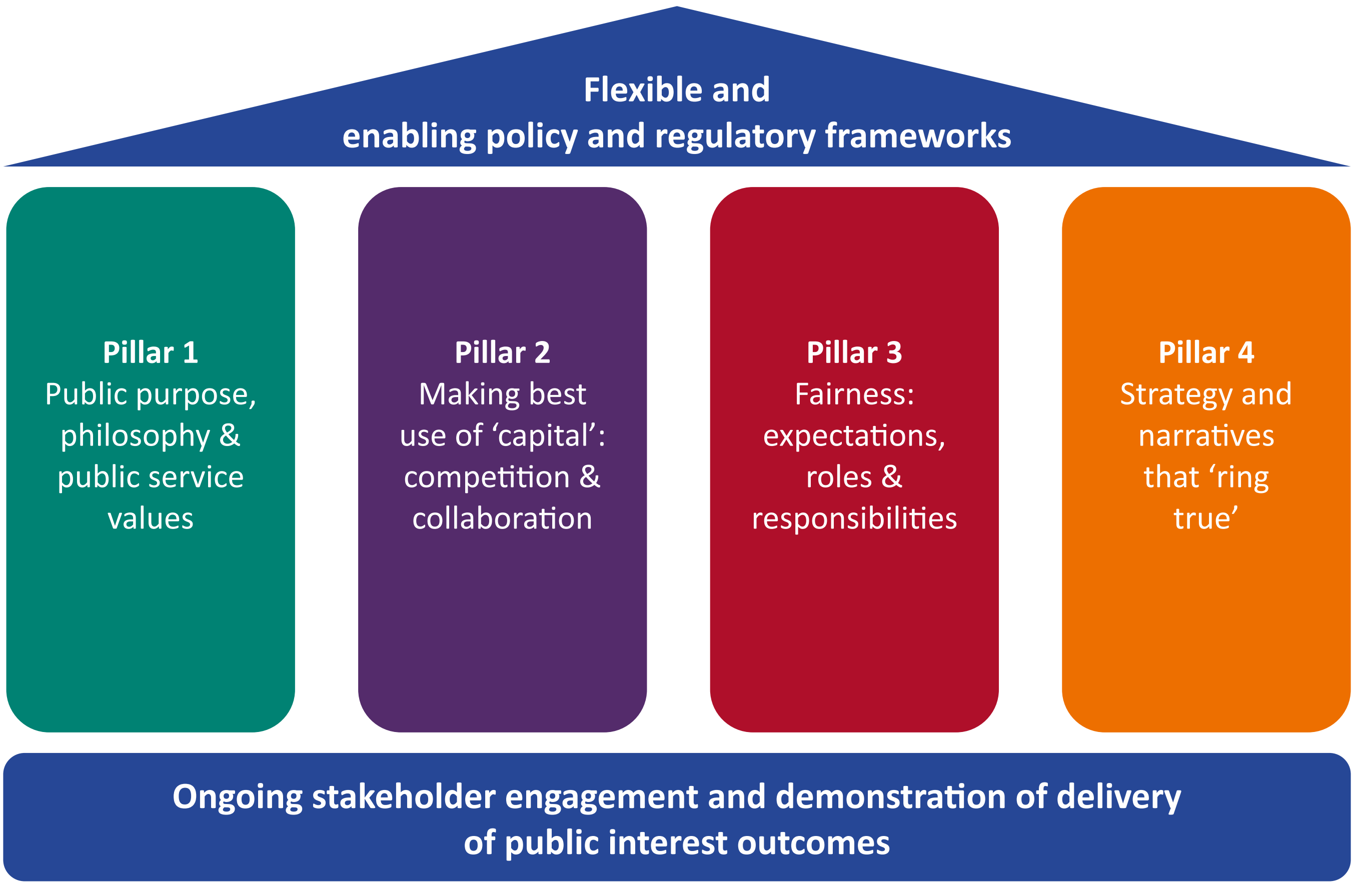
What our ‘Sustainable Licence to Operate’ looks like so far

How a ‘Sustainable Licence to Operate’ fits into this picture: For the past year, the Fair for the Future work-programme has been systematically testing the detail of a strawman ‘Sustainable Licence to Operate’ for the utilities. This is built on strong foundations of ongoing stakeholder engagement and demonstration of delivery of public interest outcomes and four ‘pillars’: purpose and values; making best use of ‘capital’ through competition and collaboration; expectations, outcomes and roles and responsibilities around fairness; and strategy and narratives that ‘ring true’ with stakeholders. Our strawman proposed that this needed to be coupled with flexible and enabling policy and regulatory frameworks.

To date, we have been exploring how far generic responsible business principles are **relevant to the energy and water sectors.** In doing so, we have sought to identify ‘responsible ongoing business practice’ for the sectors. At this point, we have not sought to create a new form of badge or accreditation.

Our work so far strongly supports the concept of a Sustainable Licence to Operate, under-pinned by the four pillars we identified at the outset. Our work also reinforces the vital importance of **people, leadership, collaboration, relationships and culture** in delivering positive change. This is central if utilities are to move from their basic focus on infrastructure and supply-side investment to a very different value-set where business drivers are focused on questions of *how* infrastructure, markets and services are operated *and to whose benefit*. This shift will be fundamental in a world where the demand side and flexibility must be harnessed to tackle climate impacts.

Developing the concept of a ‘Sustainable Licence to Operate’ in the utilities



Source: Sustainability First

Emerging thinking on what a ‘Sustainable Licence to Operate’ is and isn’t – to be tested in 2020

A ‘Sustainable Licence to Operate’ is	A ‘Sustainable Licence to Operate’ isn’t
A type of public interest compact, social contract or ‘new deal’ between a company and their stakeholders	The same as an existing regulatory licence – although meeting current licence requirements is integral to getting a ‘Sustainable Licence to Operate’
A framework for ongoing responsible business practice and outcomes	A prescriptive badge – This could have the unintended consequence of encouraging a ‘tick box’ approach. This doesn’t negate the value of new and existing accreditations for different aspects of responsible businesses
Based on engagement between a company and their own stakeholders	A generic approach – There are differences between sectors, where companies sit in the value chain, risks, resource levels, geographies, etc. – and between investors
Dependent on ongoing dialogue with stakeholders and a continuous improvement culture – it’s always moving!	‘Set and forget’ – Just as the social and environmental challenges faced by companies are evolving, so too will their ‘Sustainable Licence to Operate’
A link between a licence to invest and build infrastructure and install ‘kit’ in people’s homes and the value set needed to run and operate a service	Focused solely on gaining investor confidence to build infrastructure
Judged by corporate behaviour and culture and public interest outcomes delivered. In 2020 the Fair for the Future project will examine the Social, environmental and ‘fairness’ metrics needed to provide assurance in these areas and the cultural metrics needed to chart the embedding o fair behaviours – and what might be done to prevent gaming of these measures	Assessed by adherence to process or outputs delivered

Source: Sustainability First

Getting the basics right: Energy and water companies are all at different places on the journey towards becoming more responsible businesses. Pages 9 to 12 briefly summarise what responsible companies are already doing to gain a ‘Sustainable Licence to Operate’ in UK utilities and flag up some high-level examples of good practice. We will be expanding on this in our forthcoming **‘How to’ guide**’ in 2020. What’s clear is that although there are lots of examples of good practice, no one company ‘has it all’ and some of the activity may prove to be ‘backward-looking’ and may not be fit for a net zero world.

Fundamentally, getting the basics of service delivery right all of the time is essential to gaining a 'Sustainable Licence to Operate' and shouldn't be difficult. However, this can't be assumed to be 'in the bag' and needs continuing attention and priority before other opportunities for change can be grasped. Companies need to incentivise their staff to do the right thing for its own sake – not just because it is a regulatory requirement. This requires knowing your customers and stakeholders (through segmentation, stakeholder mapping, etc.) and being able to deliver more tailored and 'context-aware' services.

Opportunities to go further: With a growing public focus on fairness and the environment, there are opportunities and a desire for all actors to go further and drive change in the public interest:

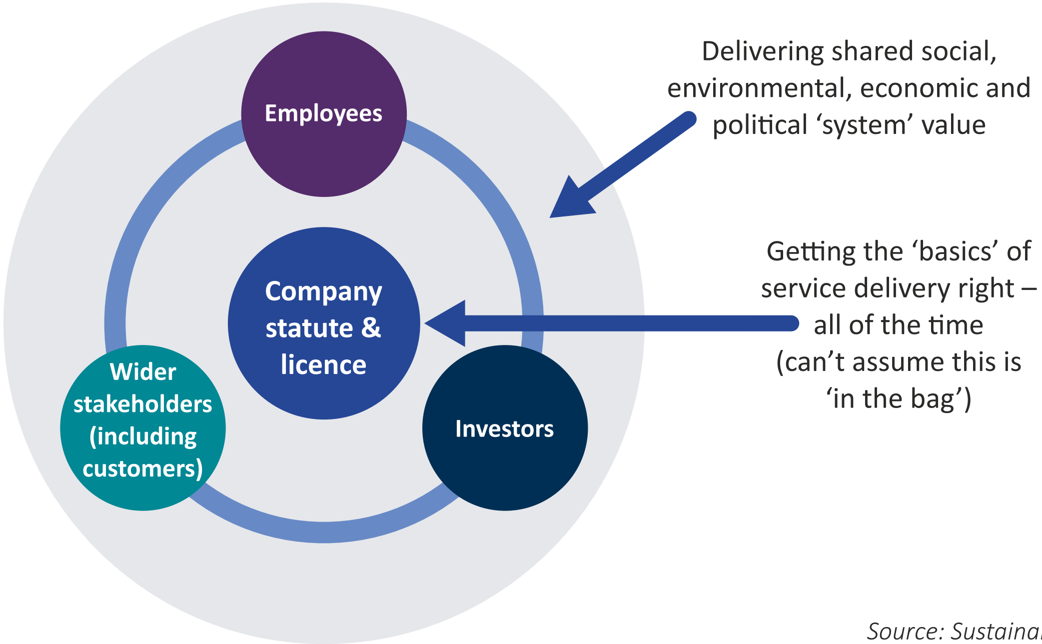
- **Windows for change –** The National Infrastructure Commission's recent recommendations in their 'Strategic investment and public confidence' report that government provides a clearer sense of strategic policy direction and that regulators have new net zero and resilience duties are important hooks for companies interested in delivering a responsible business agenda. Ofwat and Ofgem's strategy / strategic narrative documents are also helpful. However, for companies, timing is likely to be key. As water companies come out of the PR19 process, and, one step behind, gas networks and transmission companies surface from RIIO2, there is a window of opportunity to work together with stakeholders to reshape regulatory and policy frameworks so that they are fit for the future and able to deliver social and environmental outcomes – before the sectors are 'trapped' in the next price review rounds. Electricity networks can watch and learn from how the water and gas and transmission sectors evolve in this regard. We do not accept that tight regulatory settlements can only be seen as a barrier to this agenda, though they obviously pose challenges. Indeed, it is often when there are tough prioritisation decisions to make that a values approach, such as a 'Sustainable Licence to Operate,' comes into its own. Energy retailers facing significant financial constraints are also actively considering how to build a bridge to a post price-cap world. These **windows for change and crises shouldn't be wasted** and should be used to think about how to change business models so they are future-fit (e.g. potentially into public purpose platforms and public service co-ordinators) and how to build the relationships and partnerships needed to survive and thrive.
- **Sector leadership –** Given the seismic nature of disruption and challenges faced, there is a real opportunity for the energy and water sectors as a whole to use their expertise to develop a **positive vision for the future** which addresses some of the systems changes needed. Water UK's 'Public Interest Commitment' is a helpful step in this direction for that sector and is starting to build momentum. However, this needs to be developed and line up with a more strategic picture of what the sector can do to deliver social and environmental goals for the future (e.g. how they could lead cross-sector approaches to vulnerability). Companies fast tracked in price reviews will be asking themselves, *'If it isn't us, who else will lead this change?'* Page 12 highlights four priorities for frontier companies.
- **Wider stakeholder engagement and accountability –** Political and social polarisation and wider moves to redefine capitalism are forcing all sides to rethink accountability and ask which stakeholders they should be accountable to and for what.

The answer will not be one size fits all. As the value of consumer and stakeholder engagement processes are better understood, and the gaps and weaknesses are addressed, the potential for hardwiring these into ongoing decision-making processes so that they set agendas and reshape governance can be explored. This goes beyond questions of ownership and debates about workers or consumers on boards to how to give **voice** and exercise **meaningful accountability** to those whose bills ultimately pay for company wages and returns – and whose lives, communities and localities are shaped by the services provided. **These challenges need to be addressed regardless of whether companies are privately or publicly owned.**

- **Investors –** There is an increasing recognition of the importance of matching the time horizons of investors with the life of assets, in the process identifying 'natural' owners (e.g. for networks, sources of patient capital such as pension funds that as universal owners should better understand the social and environmental context that utilities operate in). There is also significant scope for new environmentally-focused sources of funding coming into the sectors such as green bonds, and even where these are not used, any investors are increasingly requiring assurance on 'Environmental, Social and Governance' Factors (see page 18), as evidenced in recent speeches by Mark Carney.
- **Building the workforce –** Responsible business and a focus on values can unlock employee energy, innovation and creativity and improve performance. **Millennial employees** in particular are increasingly keen to work in responsible companies. With the aging workforce challenge in utilities, being able to demonstrate leadership in this area can be beneficial for attracting and retaining good people. **Diversification** of skills and thinking (as well as of gender, ethnicity, etc.) is also important to help organisations cope with risk and uncertainty. Unions, education and training agencies, professional societies / associations and recruitment bodies – including head-hunters for senior positions – can all play important roles in these areas.

Early findings on current good practice by responsible utility companies

Early findings – Pillar 1: purpose and values

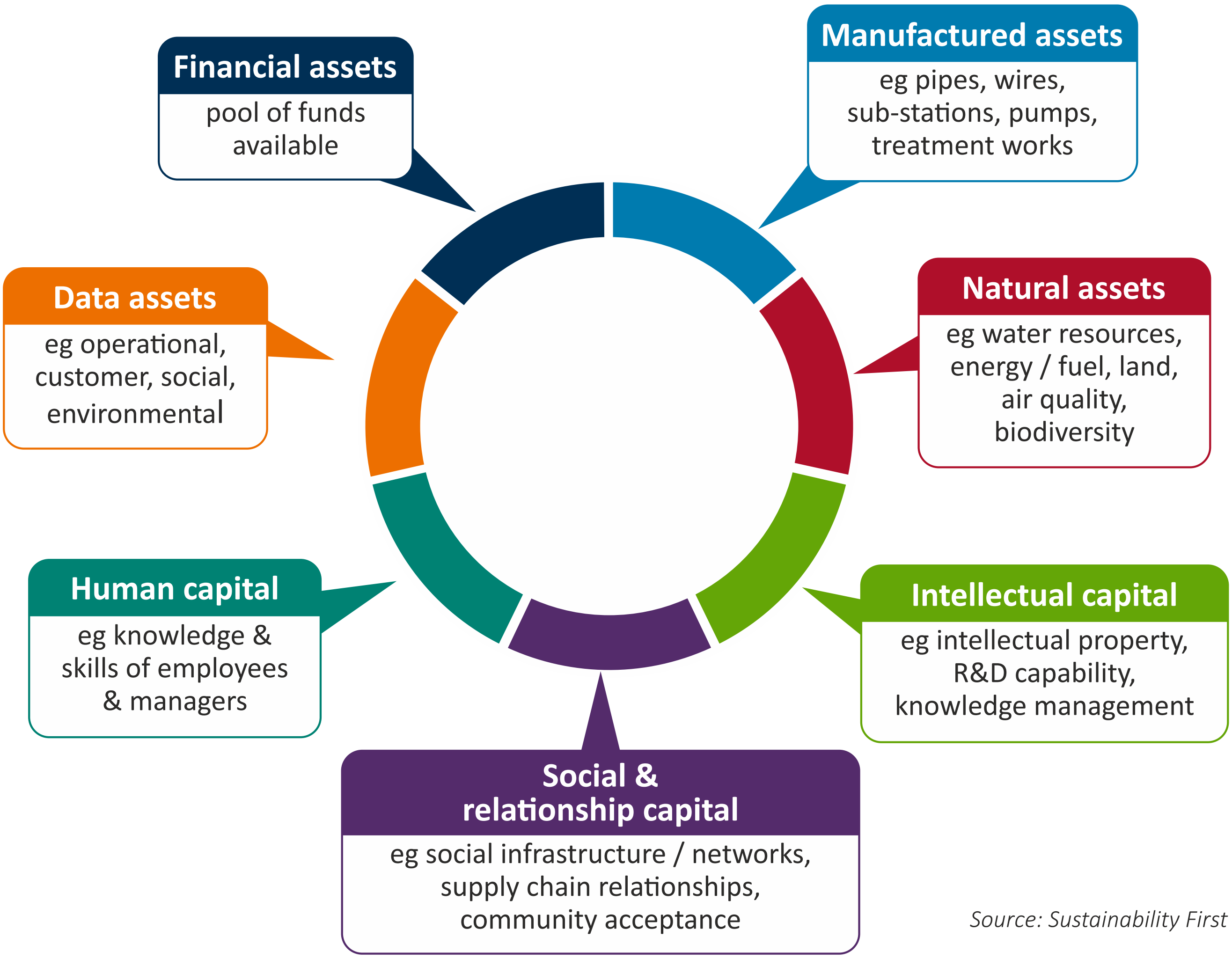


Source: Sustainability First

What a company with a 'Sustainable Licence to Operate' does differently as a result:

- Gets the basics right, e.g. asks key stakeholders what is important to them and how the company is doing – not just at price reviews or in a way / format dictated by regulation.
- Is values driven at all levels of the business with strong leadership from the top, e.g. recruits on values and ensures all staff, including frontline staff and the regulation team, understand and 'buy-in' to the values.
- Nurtures and empowers employees, e.g. Investors in People accreditation.

Early findings – Pillar 2: Making best use of ‘capital’ – competition and collaboration



Source: Sustainability First

What a company with a ‘Sustainable Licence to Operate’ does differently as a result:

- Has agreed metrics to value and measure performance across full range of ‘capitals’, e.g. integrated reporting.
- Uses a systematic approach to assessment of how best to use different ‘capitals’ so is resilient to changes in personnel etc., e.g. checklists and / or the Sustainability Director reporting to the CEO.
- Understands when it is best to compete and when it is best to collaborate, are confident about entering into collaborative partnerships and know what it means to be a good partner, e.g. through research on stakeholders’ priorities and their capacity for change.

Early findings – Pillar 3: Fairness – expectations, roles and responsibilities

Key issues	Challenges	Opportunities
1. How are future roles framed?	• 'Rear view mirror' • Ad hoc & piecemeal approach – primarily through price reviews, set piece decisions etc. • Short term outcomes for individual organisations	• Focus on long-term public interest outcomes for sectors and systems • 'Future antennae' • Strategic and cumulative approach
2. How are remits set and exercised?	• Silo-based • Limited governance of 'boundary issues' • Rigid interpretation of duties / licences etc. 'Not my responsibility'	• Cross department / sector joined up • Clear schemes of delegation – within and between organisations • 'Advocacy' & 'calling out' / signposting if issues are not within organisation's remit
3. How do roles align / balance interests?	• Focus on individual / organisation's interests • Lack of accountability / transparency in process- or this is delegated to 'technical' processes	• Focus on mutual interests • Strategic, systematic & 'legitimate' stakeholder engagement shapes process
4. How do roles flex / cope with change?	• Top down, wait and see changes to roles etc. • Roles determined by homogeneous groups drawn from largely quantitative disciplines (engineering, accountancy, economics etc.)	• 'Nail down' big decisions as far as possible to minimise uncertainty • Decisions around roles to *some extent* 'pushed down' & decentralised / distributed • Cognitive diversity and making full use of interdisciplinary skills in decision makers
5. Practical implementation	• Short-term and adversarial	• Constructive behaviours • Nested governance that emphasises common ground • Consistent application of principles

Source: Sustainability First

What a company with a 'Sustainable Licence to Operate' does differently as a result:

- Addresses boundary issues and silo approaches – e.g. if it's outside their control, helps facilitate change or signals / advocates to others what needs to be done.
- Transparently explains why they are sharing risk and reward on the basis that they are, e.g. listens to stakeholders and ensures reporting formats tailored to meet different stakeholder needs and interests.
- Encourages innovation for all, e.g. to build capabilities of stakeholders to change.

Early findings – Pillar 4: Strategy and narratives that 'ring true'

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 & positive reporting culture
Short-term, internal and piece-meal data	Integrated metrics developed following engagement	Metrics reflect long-term and systems value
Backward-looking	Forward-looking	Strategic
Measure 'things'	Measure culture and behaviour	Measure public interest outcomes – within & between generations
Static	Iterated	Evaluated
One size fits all	Tailored to target audience, providing meaningful explanations	Help shape policy and regulation

Source: Sustainability First

What a company with a 'Sustainable Licence to Operate' does differently as a result:

- Develops metrics with stakeholders that are relevant to stakeholder needs / requirements.
- Ensures meaningful accountability, e.g. giving voice and listening and answering to consumers and communities outside of AGMs, etc.
- Ensures strategy and narratives are aligned and creates a positive narrative for change – e.g. alignment through organisational design and vision for the company and sector.

Emerging conclusions – Four priorities for frontier and leading companies

1. **Engineering plus** – Embed purpose, vision and culture to become a safety- and values-driven business where all employees are empowered to do the 'right' thing whatever the circumstances.
    - Accreditations, standards, certifications, etc. – evidence and lock-in positive change.
2. **Break out of the price review cycle** – 'Call-out' when change is needed in policy and regulation and help to redesign frameworks and relationships.
    - Create safe spaces to discuss difficult strategic and / or distributional issues.
3. **Stakeholder engagement: consumers and communities** – Go beyond compliance to unleash the demand side, open new opportunities and reshape governance.
    - Address democratic deficits in way that is meaningful to stakeholders, transparently shares risk and reward and gains third party support and endorsement.
4. **Get the right metrics and balanced scorecard in place** – So know what to prioritise and when to partner across full range of resources and so can transparently demonstrate acting responsibly for the company and the system in which it operates.
    - Aid to forward decision-making and proactive action in delivering social and environmental outcomes.

Initial conclusions on the evolving risk landscape – and the particular challenge in defining, measuring and demonstrating fair outcomes

Why look at the risk landscape? It is not enough to think about a 'Sustainable Licence to Operate' in isolation. A risk 'lens' can help in thinking about why and when a 'Sustainable Licence to Operate' is needed. Risk is the 'bread and butter' of utility investors. Developing a **common language** around risk – and what this specifically means in utilities and to a company's different stakeholders – is important. In particular, too narrow a focus on operational risks can miss the bigger picture. Successful companies track their strategic risks, and a 'Sustainable Licence to Operate' is an important part of mitigating these risks.

Social and environmental outcomes and risk: Established approaches to considering risk in utilities can struggle to assess social and environmental outcomes and risk – as these things can be seen as externalities or 'one-off' reputational issues. This can make it difficult to understand how these risks impact on wider political uncertainty and regulatory risk. Given the extent of disruption faced, this is becoming a growing issue. Although this is not a unique problem to utilities, as they provide public functions, in many ways they are in the front line in terms of how these issues are dealt with. **Who should bear social and environmental risks and who should reap the rewards is a key issue that sits behind many of the questions of fairness in utility companies.** Three key challenges are faced when tackling this question:

1. **The millstone of history –** The high returns earned by many monopoly utilities in the past decade or so were often on the back of companies claiming that their businesses were riskier than proved to be the case. Although much of this money may now have literally left the country and new owners may be in place, this legacy makes many sceptical when companies say they face new or increased risks – and that they and the regulatory system in which they operate are well placed to address these.
2. **Fast and furious –** Social and environmental risks are dynamic, interconnected and have multiple feedback loops. And due to the legacy issues noted above, people are often angry about them, which can lead to difficult to predict 'tipping points.' As some of these (particularly climate risks) may prove to be irreversible, they need to be given due attention. Our research has identified four '**dynamic risk factors**' that can lead to political uncertainty and regulatory risk: the consumer lived experience; climate and the environment; the media; and civil society. These new risk factors are already shaping the world in which companies operate and most recognise the need to get ahead of these to survive, innovate and thrive.
3. **Moving beyond 'green and purpose-wash' –** How to internalise social and environmental risks and integrate and embed them into decision-making processes so that they are not an afterthought or bolt-on analysis requires new approaches to reporting, assurance and metrics.

Creating a 'permissive' environment for change: Our research on political uncertainty and regulatory risk in terms of fairness indicates that companies cannot sit by and wait for policy makers and regulators to champion the shift to more forward-thinking responsible business. Forward-looking companies are already seeking to better understand and tackle these evolving risks and to move from negative spirals – where their legitimacy may be challenged – to positive ones where they can help create a 'permissive' environment for positive change in the public interest across the board (see pages 14 and 15).

The dynamic risk factors that are shaping political uncertainty and regulatory risk

Dynamic risk factors -
consumer lived experience,
climate/the environment, the media & civil society - shape

PROHIBITIVE ENVIRONMENT
Enforcement action
Firefighting
'Tainted by association'
Focus on retrospective claw-back

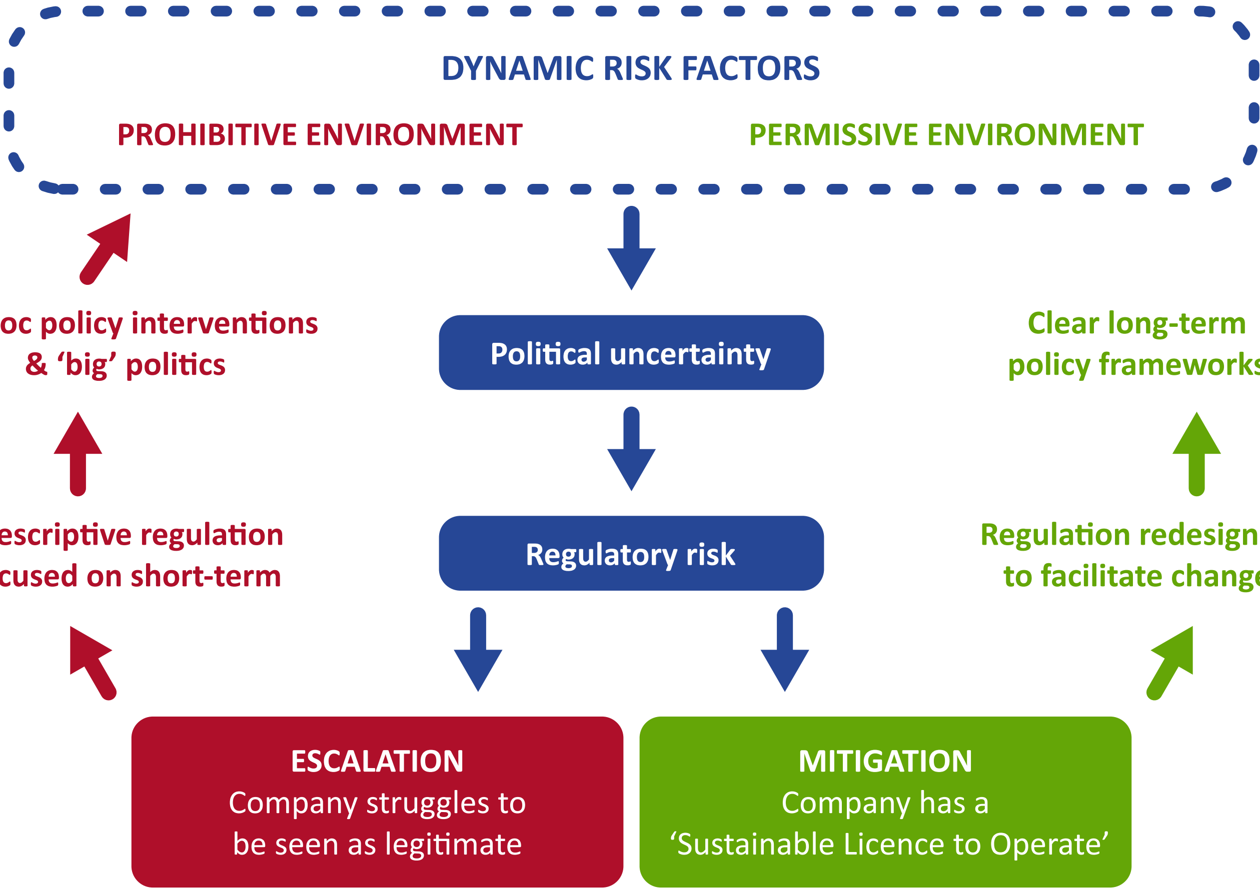
PERMISSIVE ENVIRONMENT
Permission to operate
Headroom to deal with problems
Trustworthy partner
Legitimacy to grasp new opportunities

Political uncertainty
eg net zero, nationalization,
ideology, 'brutal' politics, Brexit etc

Regulatory risk
eg statutory duties, price controls, cost
of capital, depreciation, dividends etc

Source: Sustainability First

How a ‘Sustainable Licence to Operate’ can help create a ‘permissive’ environment to address the politics of fairness

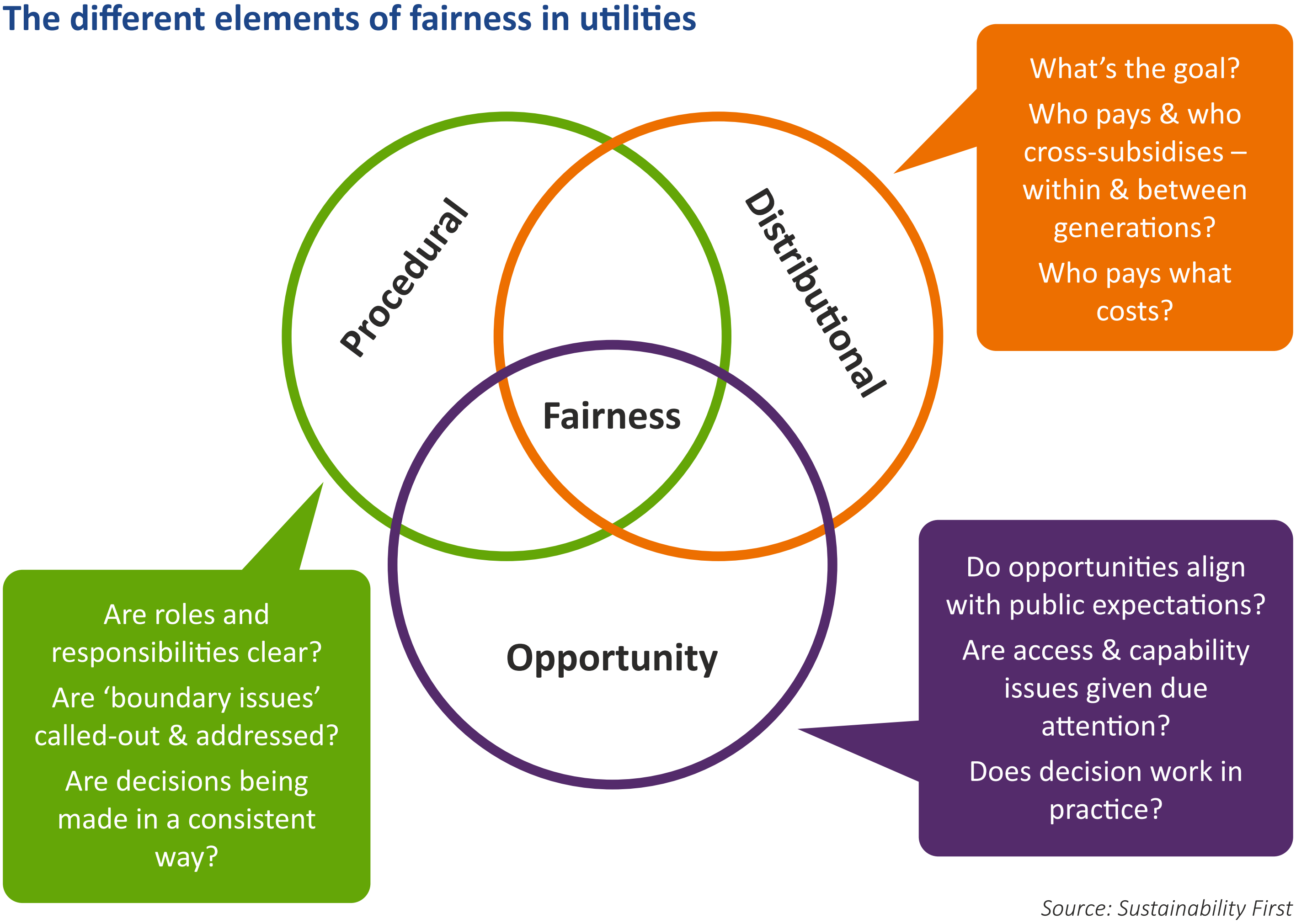


Source: Sustainability First

Defining outcomes for fairness: There is the beginning of a loose consensus that ‘fairness’ in essential services has different elements: procedural (e.g. ‘fair process’, democratically agreed priorities and hierarchies for addressing the ‘big’ issues and ‘big tent’ discussions which seek to align and balance different interests – rather than relegating these to fragmented technical annexes); distributional (e.g. equality where all pay the same; equity where people pay what they use; or ability to pay where payments take affordability into account); and fairness of opportunity (e.g. access to smart tech such as EVs, capability to go online and get a good deal or seek redress, etc.). These three factors play out in different ways depending on the time frame, geography (internationally, nationally at the devolved level, regionally and locally) and ‘publics’ in question.

Until recently, the focus in utilities has largely been on economic fairness and not on the political (with a small ‘p’) or sociological dimensions of fairness – not to mention the ethical or moral dimensions (e.g. fairness within generations in an era of flat real incomes, and stagnating progress in reducing inequalities and fairness between generations when we run the risk of not leaving the planet in a state that our children will be able inhabit or enjoy). The climate crisis and social inequality are changing this.

The different elements of fairness in utilities



Source: Sustainability First

Need to recognise difference: Developing a one size fits all 'badge' for fair and responsible businesses in the utilities and their role in addressing questions of fairness is a challenge. **Companies** are in different places in terms of fairness issues; much depends on the sector, where each company sits in the value chain (e.g. network monopoly or competitive retailer) and their own risks and opportunities. These issues are particularly acute in dynamic competitive markets where an individual company's actions are influenced by the actions of their competitors as much as by regulation and policy. Similarly, it is difficult to generalise about **ownership**; there are differences between equity and debt, public and private, and short- and long-term investors.

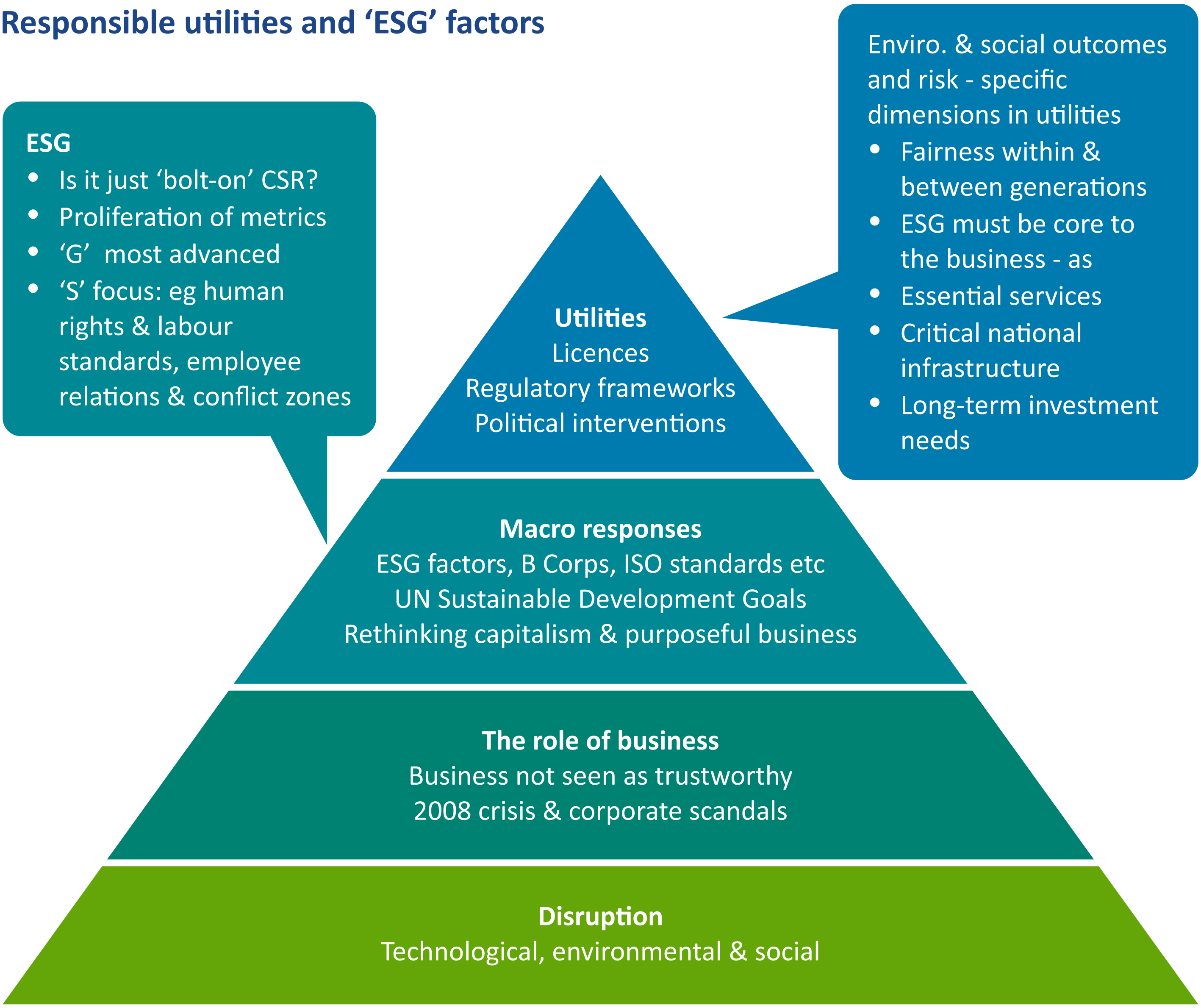
Demonstrating that a business is delivering fair and responsible outcomes: Although there is increasing interest in fairness issues, companies are still experimenting with how best to assess and evidence that they are acting responsibly and in a fair way across the full range of issues that they need to deal with. There is also a recognition that measuring the **'cultural' factors** that drive behaviours and judgements around fairness can be challenging. More systematic approaches include the following – they're clearly not mutually exclusive:

- **The UN's Sustainable Development Goals (SDGs)** – Now increasingly seen by companies as a framework for the interrelated factors a responsible business needs to weigh up and consider when developing strategy. Policy makers and regulators are yet to fully get behind the SDGs as a tool for assessing responsible business in the UK context.
- **Investors and 'Environmental, Social and Governance' (ESG) factors** – Investors are currently using a plethora of standards to measure ESG factors (~120+). This can be confusing. Whilst many are comfortable in measuring governance factors, they have less

hard data on environmental factors and often really struggle to measure social factors. This may be due to the uncertain financial impacts of 'E' and 'S' and the often qualitative nature of 'S' – and the fact that views on what is socially 'just' can vary among investors from different countries.

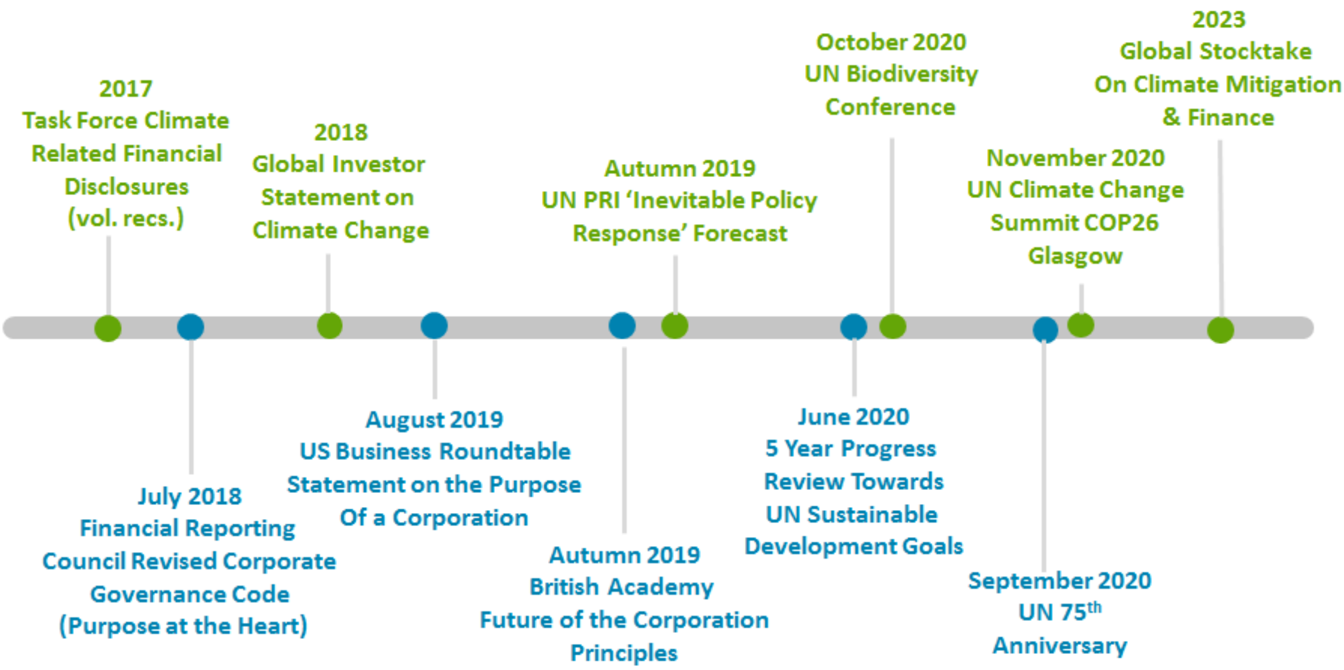
- **Accreditations and standards** – E.g. B Corps, BSI standards, Business in The Community (BITC) responsible business map, tracker and awards, etc.
- **Changing Memoranda and Articles of Association** – To put purpose at the core of business activity and lock this in to withstand changes in leadership, ownership etc.
- **A principles-based approach** – Adopting principles of responsible business and a 'comply or explain' approach.
- **Consumer and public interest outcomes** – Although there is a recognition that consumer outcomes are important, a set of recognised outcomes for regulated utilities that covers both consumer and what the National Infrastructure Commission has termed 'general public' outcomes has yet to emerge. Redefining the 'consumer lived experience' in the sectors and seeing this 'in the round' is a first step towards this. Our working note on this subject points the way.
- **Customer assurance** – Spurred on by regulatory requirements, many companies are now embedding consumer engagement in their decision-making processes and using it as a proactive way to provide board assurance. However, with concerns about 'capture', regulators can be reluctant to give this due weight in price control settlements. Who sets the agenda and terms of engagement going forward may well be contested.

Responsible utilities and ‘ESG’ factors



Source: Sustainability First

Snapshot of a Rapidly Evolving Landscape in Terms of ESG Factors



Source: Sustainability First

Our initial thoughts on how a 'Sustainable Licence to Operate' should impact future approaches to policy and regulation

Redesigning policy and regulatory frameworks to deliver on outcomes for fairness and the environment: The National Infrastructure Commission's recent report on strategic investment and public confidence makes some very helpful recommendations in terms of the steps that can be taken in the short to medium term to **clarify roles and responsibilities** and help **navigate boundaries** in terms of distributional issues – and to enable a **plurality** of solutions to come forward at the **local, regional and devolved levels**. However, **more fundamental changes** will be needed to policy and regulation to get the systems change necessary for a net zero future that: a) creates a policy framework of duties for making decisions when there are conflicts of interests, crucially around significant questions of inter-generational equity, to enable a **just transition**; b) breaks down the silos that may get in the way of developing new **integrated and circular solutions** that use limited resources more efficiently and effectively; and c) ensures public confidence not just in terms of getting assets built but also how these are operated and run.

Flexible and facilitative regulation: The new government, the National Infrastructure Commission's recommendations, and the proposed Office of Environmental Protection, could all have significant implications for Ofgem and Ofwat – as well as of course the Environment Agency. As all sides wait to see how these things play out, regulators will want to see how far they can address distributional and fairness issues under current arrangements (e.g. through using new techniques to address distributional issues and augmented cross-sector working). There can be more **scope for change in existing arrangements** than is often assumed. Regulators may also want to consider how to **prioritise** any new duties they may be given compared to their existing ones. Given the social and environmental disruptions faced, thinking how they can do this in a **flexible** way that **facilitates** fairness and enables new **markets** to develop – that deliver positive social and environmental outcomes and attract responsible businesses – will be important.

This could entail taking a more **pluralistic regulatory approach; principles-based** for companies that are able to demonstrate that they behave responsibly – whilst continuing to provide a more prescriptive approach and ultimately tough enforcement action for poor performers. Putting much greater emphasis on regulation for the demand side and platforms – and recognising that modern utilities aren't just about pipes and wires and getting meters on walls – is likely to be key. Public value licence conditions and fit and proper tests for new owners could all play a part here. We will be returning to the issue of what regulatory models may be responsive to a 'Sustainable Licence to Operate' in 2020 and exploring questions such as how much reliance regulators can place on accreditation schemes, standards, etc.

Rewards for delivering as a responsible business: Policy and regulation will always struggle to keep up with the pace of change needed leading to the frameworks within which companies operate often lagging behind the challenges faced on the ground. Although there are significant fundamental drivers for change, in the current **tight price control environments** in both energy and water, and with the challenging energy retail market, it is not always clear what the upside of being a responsible business is – particularly in the short- to medium-term. The volatile political environment, policy vacuums and silos and concerns that evidence and impact are not always valued accentuate this problem. However, companies that wish to survive and thrive will recognise that the **social and environmental issues** that a 'Sustainable Licence to Operate' will address **are not going to go away** and will, in all likelihood, only get more acute. Being at the **forefront** of addressing these

issues is not only morally the right thing to do for society and the environment but also has business benefits – in particular being able to make the most of newly emerging **'environmental' markets.** The growing demand for ESG from UK, European and Canadian equity **investors** – coupled with the **low interest rate** environment making infrastructure an attractive assets class to invest in – is also encouraging many companies to recognise the upsides of a responsible business approach.

It takes two to tango: Nearly all sides recognise that the current relationship between policy makers, regulators and companies is not healthy and needs to be strengthened considerably if the utilities are going to be able to play the key roles envisaged for delivering net zero – and if they are to do this in a fair and inclusive way. Getting the right relationships in place and focusing on common interests and the long-term outcomes sought will be key. Things will be difficult; some companies will fail and some assets will be stranded. To build a culture of trust where difficult conversations can happen will necessitate a more depoliticised environment and **'safe spaces'** if all sides are going to move forward in the public interest. Utility companies, with their expertise and resources, should make the first moves. A 'Sustainable Licence to Operate' provides a positive framework and assurance mechanism to enable them to do this.

"Utility policy and regulatory arrangements need to acknowledge and internalise wider approaches to standards and accreditation. Above all utility regulation needs to establish agreement on approaches to valuing and measuring outcomes for beneficial social and environmental change, including on changes in company culture, as this will shape how judgements around fairness are made. We will be looking at this in the next phase of the Fair for the Future project."

Building the evidence base for change: new outcomes for fairness and the environment

The Fair for the Future Project has carried out extensive primary and secondary research. We are mid-way through our research programme. Given the rapid pace of change, and interest in this project, we are publishing and iterating our work as we go. All final materials are available on our website at https://www.sustainabilityfirst.org.uk/fair-for-the-future

Research and publications to date

- Desk research: 'Sustainable Licence to Operate' strawman framework and issues report (10/2018).
- Desk research: 'Conventional' approaches to uncertainty and risk in terms of fairness and the environment in the energy and water sectors discussion paper (10/2018).
- Four high-level all-day 'action research' workshops to test proposals with key stakeholders. ~40 attendees at each, including: companies; economic and environmental regulators; government departments and agencies (e.g. BEIS, NIC, CCC); consumer and environmental groups; trade unions; wider civil society groups; representatives of the supply chain; academics.
- Five deep-dive case study papers from outside the sectors / overseas.

Deep-dive good practice case studies from outside the sectors and overseas	
MAG	Embedding thinking on **purpose** to manage the impact of operations in Manchester Airports Group
COVENTRY Building Society	Being a **values-led** business for savers at the Coventry Building Society
Thriving Communities Partnership Connect. Collaborate. Impact.	Cross sector **collaboration** to tackle vulnerability by the Thriving Communities Partnership – established by Yarra Valley Water in Australia
Peabody	Understanding the needs of social housing tenants in the Peabody Group and the respective **roles and responsibilities** for those supporting them, and placing this at the heart of business strategic decision-making
nest NATIONAL EMPLOYMENT SAVINGS TRUST	Using new language, behavioural interventions and **narratives** to redefine pensions at Nest Corporation and across the pensions sector

- Primary research: ~30 'talk into action' discussions with energy and water companies on how they embed purpose in their organisations.
- Primary research: ~10 risk discussions with energy and water companies to build a bank of good practice on how they deal with political uncertainty and regulatory risk in terms of social and environmental factors, and analysis of company principal risk and risk appetite statements in this regard.
- Desk research: Working notes on 'dynamic risk factors' – the consumer lived experience (10/2019); the environment and climate (in progress); the media (4/2019); and civil society (2/2019).
- Expert roundtable to test emerging conclusions with nine investors – and two bilateral meetings with fund managers (10/2019).

Proposed next steps for the Fair for the Future Project

- Expert roundtables / interaction to test emerging conclusions and develop thinking on metrics (e.g. with company secretaries, think-tanks and politicians).
- War games to iterate conclusions.
- Legal advice on regulatory duties / approaches.

Final outputs

- Report on the implications of a 'Sustainable Licence to Operate' approach for policy and regulation and the social, environmental and cultural metrics and balanced scorecard that are needed to provide assurance to stakeholders that a company is acting fairly and responsibly.
- A 'How to guide' for developing a 'Sustainable Licence to Operate' – sharing our detailed bank of good practice examples and deep-dive case studies.
- Research paper on how political uncertainty and regulatory risk in terms of fairness and the environment are currently dealt with in energy and water companies and by investors.
- Stimulus paper on how approaches to social and environmental risk need to change in the disrupted world.
- Fair for the Future Project Synthesis Report.

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Editorial responsibility for this report rests solely with Sustainability First.

Sustainability First – What we do

- An independent charity and think-tank, we shape sustainability policy and regulatory agendas for the benefit of consumers, citizens and the environment.
- Focused on UK utilities and the public interest, our expertise, analysis and research make us uniquely placed to turn talk into action in the move to net zero.
- We promote practical solutions that bring people with us to deliver environmental, social and economic wellbeing.

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 public utilities.

www Visit us
sustainabilityfirst.org.uk

Email us
info@sustainabilityfirst.org.uk

Follow us
@SustainFirst

Write to us
C/o IEEP, 3rd Floor,
11 Belgrave Road,
London, SW1V 1RB

Registered Charity Number: 1078994

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