

Balancing Act: How to Align Social and Environmental Interests in the UK in the Light of the Pandemic and in the Pursuit of Net Zero

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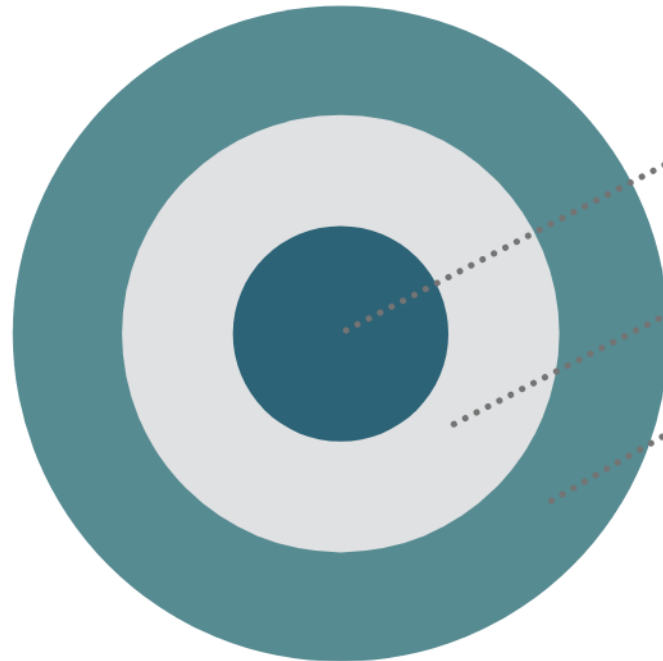
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Sustainability First

We are a think-tank and charity that works in essential services to promote practical solutions to improve environmental, social and economic well-being. We seek to bring about social and cultural change for a more sustainable future.

Our aims



Shape agendas - bring stakeholders together to drive strategic thinking on key topics

Embed sustainability - push thinking in new directions through informed engagement

Connect, inspire, engage - use creative, collaborative and inclusive approaches to engage broader groups in society on difficult choices and to identify innovative solutions



Fair for the Future Project, 2018–2021

This presentation draws heavily on our Fair for the Future Project research. This project sought to enable UK utility companies, policy makers, and regulators in energy, water and communications to better address the politics of fairness and the environment. This is key to balancing social and environmental interests

Overview of key findings

- We are going through a period of significant uncertainty – net zero is one challenge faced but not the only one
- Need to step back and undertake fundamental redesign of the system and approaches to decision making – not just tinker at the edges
- To navigate change, balance interests in a fair way and deliver public value, need to give more attention to purpose and behaviours of all actors - companies, investors, policy makers, regulators and the public



Fair for the Future Project, 2018–2021

How to balance different interests

- **Engagement** – for citizens and communities, not just consumers
- **Disclosure, reporting and metrics** – including for long-term issues and cultural indicators
- **People, culture and governance** – to develop trust and enable innovation and appropriate risk taking
- **Focus on purpose and integrate this into strategy** – this is not an add on!
- **Regulation concentrating on only the things regulation can do** - less prescription more ethics – and giving companies ‘earned autonomy’
- **Clearer government signals** - on social and environmental issues, including who pays for welfare



Major Three Year Research Programme

What has the Fair for the Future Project done?

1. Developed and tested a 'Sustainable License to Operate' for purposeful utility companies. Strawman tested in four multi-party one day action research deliberative workshops and against 18 case studies, including 5 deep dives outside utilities. Depth interviews with companies on how they put 'talk into action' in key areas
2. Reviewed the sustainability metrics used in these sectors – including in a roundtable with investors
3. Mapped political and regulatory risk and uncertainty, in terms of fairness and the environment, for utilities. Carried out literature review and then primary research with companies
4. Commissioned Slaughter and May to review the interaction of law, regulation and sustainability in utilities from a legal perspective
5. Published a Discussion Paper - Regulation for the Future: the implications of public purpose for policy and regulation in utilities. This drew on literature review and multi-party workshops on the role of stakeholder engagement and adaptive regulation in future approaches



Why is Fundamental Change Needed?

- Multiple inter-related challenges
 - Environmental – net zero, climate impacts, biodiversity loss etc
 - Social – inequality, Covid-19, climate impacts, fourth industrial revolution structural impacts on employment etc
 - Economic - AI, big data, Brexit etc
- Significant uncertainty. Social and environmental risks can amplify each other if not addressed
- With climate change, the past will not necessarily be a good guide to the future. The counter-factual is not the world as it is
- Need to make decisions at scale and pace – and cope with ambiguity
- Need systems change – got to work across silos and take coherent and cumulative view of shifts needed

- Existing tools – and the compliance mindset these create - will not be sufficient to deliver net zero/public value
- The roles, responsibilities and approaches of all actors need to change
- Different approaches needed which can help identify common ground, deliver co-benefits, align interests and deal with trade offs – such as who pays for decarbonization and climate adaptation - in a fair way
- A focus on public purpose – for all decision makers - is a key part of this shift



What is an Organisation's Public Purpose?

“An organisation’s public purpose is the **distinctive contribution** that it makes to society and the environment in which it operates. It is **what the organisation is there to do** in terms of the **impacts** it has on its customers, citizens, communities and the environment and how these impacts **create societal value.**”



Why Organisations Should Focus on Public Purpose

A focus on public purpose can help essential services like energy deliver public value - including net zero

For **companies**, it is also in their own interests

- **Driving value creation** – it can help them cope with technological change, withstand social/environmental/economic shocks, foster innovation, and motivate and inspire their teams to connect culture and strategy
- **Investor pressure** – Environmental, Social and Governance (ESG) factors provide financial resilience. A focus on purpose can provide assurance to investors and other stakeholders on progress
- **Legal requirements** – Financial Reporting Council 2018 Corporate Governance Code
- **Attracting talent** – recruiting and retaining millennials
- **Regulatory pressure** – GEMA Chair's letter to energy network company chairs on governance and board leadership



Key themes That Underpin A Purposeful Organisation

1. Ongoing stakeholder engagement

- Company uses engagement to identify strategic and local priorities for its area of operations
- It develops strategic partnerships and collaborations
- It understands what fair returns / fair share of risk and reward looks like

2. Demonstration of how it delivers on its social purpose – disclosure

- Measures performance against full range of activities – holistic reporting
- Develops coherent narratives
- Shows leadership for itself and the sector

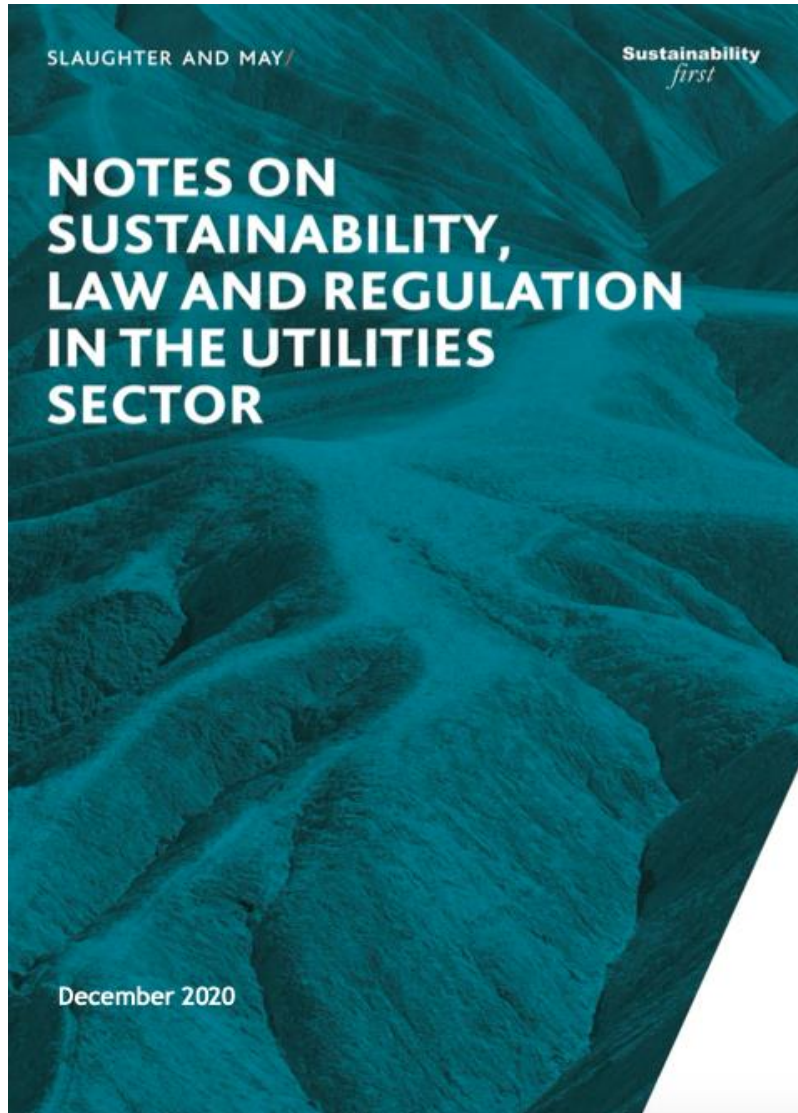
3. Ensures people and culture are focused on purpose

- Develops purpose and values with team
- Recruitment, reward, retention and succession planning aligned with purpose
- Open to internal and external challenge on how delivering on purpose

4. Integrates purpose into core strategy

- Systematically considers purpose in strategy and decisions around trade-offs
- Ensures approach to purpose is embedded across organization
- Develops coherent and holistic evidence base on impact re purpose

What About The Law and Regulation?



- This pro-bono work examined legal and regulatory frameworks and sustainability in energy, water & comms
- **Sustainability First's** conclusion - there *is* scope within current arrangements for more to be done to encourage purpose/delivery of net zero etc
- Companies and regulators have flexibility within the existing regimes to support sustainability practice
- Key questions are the '**4 i's**' – how policy makers & regulators:
 - **Influence** – who are they influenced by?
 - **Interaction** – how do they interact within/ between sectors?
 - **Interpretation** – how do they interpret the law and regulation and deal with trade-offs etc?
 - **Implementation** – how do they implement the law and regulation in practice?
- Organisational **culture** will determine how these questions are addressed

Implications of Purpose for Policy Makers and Regulators

- Companies and regulators have freedom to adopt a more purposeful approach – but this is easier if there is a supportive culture – for companies from regulators and for regulators from policy makers
- Some regulator/ company interactions are almost institutionally adversarial, based around series of bureaucratic one shot games. This is at best an unnecessary distraction given net zero, climate adaptation, biodiversity, deprivation
- Thirty years after privatisation, need to fundamentally rethink policy and regulatory frameworks so that they can enable the purposeful approach needed for a disrupted world – and wider system change



The Need for Change Has Been Recognised

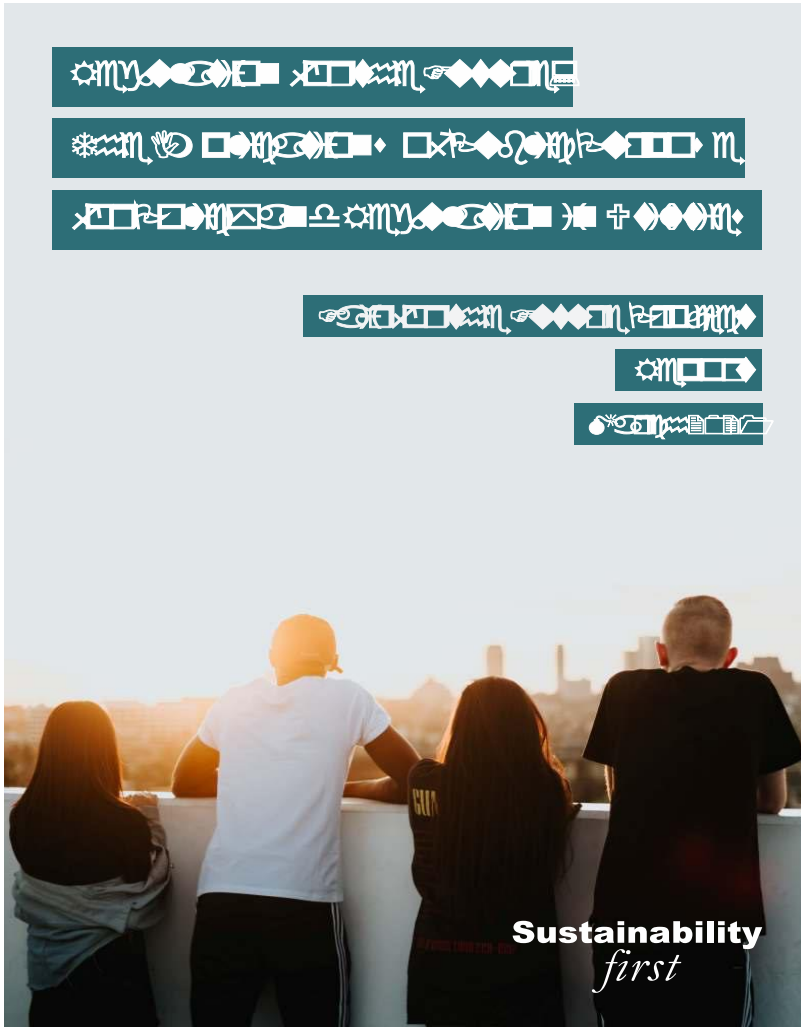
- Ofgem adaptive regulation – e.g. reopeners. In principle should create more flexibility within price review periods
- Greater focus on customers in vulnerable situations (though not yet enough or sufficiently joined-up across sectors)
- Early stage cross-regulator work on net zero
- Increased focus from the Financial Reporting Council on culture



Regulation for the Future: Agenda Shaping Report

Report recommendations will help shape forthcoming:

- HMT review of economic regulation
- BEIS (and Defra) Strategic Policy Statements
- BEIS review of affordability and fairness in the energy sector
- RII02 reopeners and RII03 – and PR24 in water



Regulation Needs to Shift It's Focus

Regulatory interventions should be less prescriptive. Price reviews should concentrate on:

- Cost of capital (though could arguably be done across regulators)
- Major baseline total expenditure (totex)
- Major new spend

For other activities, regulators need to move to:

- Risk based regulation/third party assurance/earned autonomy
- New freedom for companies to use modest amounts of baseline totex to respond to community/local need – determined through local negotiated settlements/deliberative engagement
- Ethical regulation and a culture change in regulators



Government's Role Needs to Change

- Adopt the purposeful business agenda
- Forthcoming HMT review of economic regulation
 - New statutory duties, on net zero and climate resilience – for Ofwat, Ofgem and Ofcom
 - Enhanced Strategic Policy/Direction Statements – including across regulators
 - Shift focus of regulation from customers to customers and citizens
- Clarity on relative roles for welfare state and vulnerability tariffs/support
- Extend work on fair transition to climate change impacts
- Reappraisal of the role of place and local democracy/ communities in utilities
- Appointments to regulator boards, producing more diversity of thought and commitment to purpose/public value
- NAO need to support appropriate regulator risk taking

Need Greater Focus on the Long-Term

- National Infrastructure Commission role as voice of long-term, stop issues being pushed right
- Adaptive planning – start with the long-term aim and work backwards. Use of scenarios. Align price reviews with long-term glide path
- Build trust - adopt sustainability principles (we will come to this shortly), create safe spaces and use scenarios
- Role for pilots, but much to learn about mainstreaming



Final Thoughts and Next Steps

- We absolutely need technological change to reach net zero – and to use hard levers such as carbon taxes
- This will be necessary but not sufficient to deliver a fair climate future
- A greater focus on culture, behaviours and mindsets will also be needed to cope with change at the pace and scale required – and to deal with difficult ethical trade-offs
- Investor pressure has led to a recognition of these issues by many companies
- But there is a danger of green wash!
- For change to be meaningful, policy and regulatory frameworks also need to change – to put purpose front and centre – less economics, more citizen and wider ESG factors
- Our research has highlighted that there is much the energy sector can learn from water companies here
- But to get fundamental systems change also need a common set of principles and values that all sides can refer to to help them navigate uncertainty and to address impacts in the round and over time
- Sustainability First's new 'Sustainability Principles' project is now starting to address this issue – working with companies and key decision makers in the energy, water and comms sectors to support the cultural shift taking place to mainstream sustainability



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