

New Energy and Water Public Interest Network New-Pin

**Energy and water:
How effective is your board in delivering ‘future
customer’ and wider stakeholder outcomes?**

A Sustainability First check-list for
energy & water board effectiveness

Annexes 1-4

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Sustainability *first*

Annexes

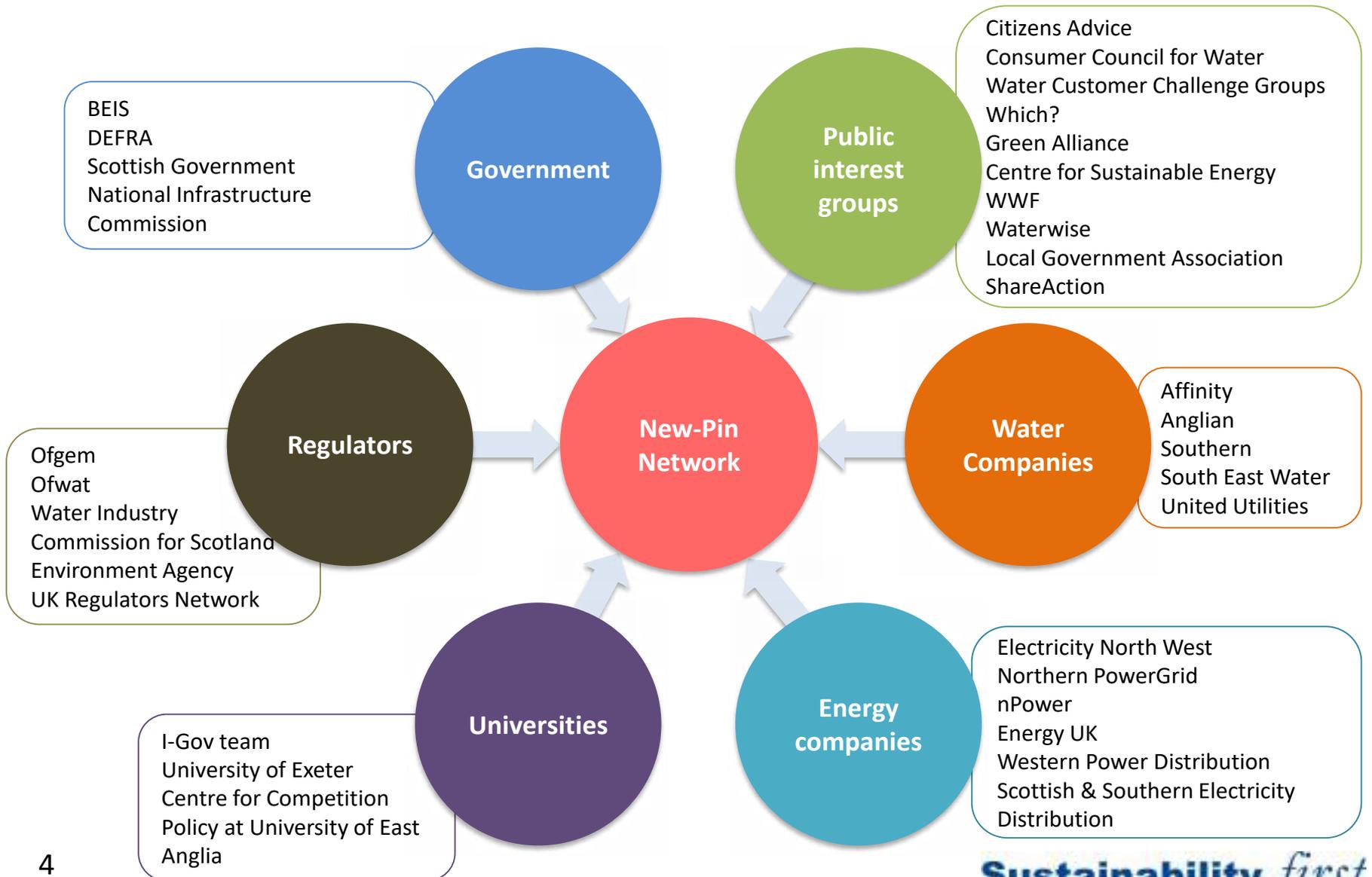
These Annexes contain some generic information on governance. We've included this to be comprehensive & inclusive in our approach

1. New-Pin: overview and objectives for governance work
2. Definitions: governance; the role of the board; and corporate structures
3. New-Pin approach to governance and research methodology
4. Energy and water: why specific focus on governance in energy and water and sector specific requirements
5. Key findings, different perspectives and case study insights from elsewhere
6. The changing corporate governance landscape

Annex 1: About New-Pin

- The New Energy and Water Public Interest Network ('New-Pin') - a ground-breaking project
- We are building understanding and consensus around long-term public interest outcomes for the energy & water sectors
- The Network (see next slide) is building a 'common voice' for greater long-termism
- We have examined how to balance short- and long-term pressures for the sectors - on specific 'difficult' topics
- New-Pin provides a framework and 'tools' for stakeholders – to help step-back and explore big picture / strategic risk
- The energy and water sectors have strong inter-dependencies. These need to be better understood / managed
- Sharing lessons and case studies. Spreads good practice across both sectors. Avoids repeat mistakes

Annex 1: New-Pin – Who's involved?



Annex 1: Objectives for New-Pin governance work

What we seek to achieve in energy & water sectors in terms of governance



Annex 2: Definitions

Governance and the role of the board

Corporate governance: The system of statute, rules, practices and processes by which a company is directed and controlled. It is about what the board of a company does and how it sets the culture, values and ethics of the company

Board of directors: Group of executive and non-executive Directors elected by shareholders to govern company

The role of the board: Within this framework, the board exists to promote the long-term success of the company by collectively directing the company's affairs for the benefit of its members as a whole. In doing so, its directors must have regard to: the likely consequences of any decision in the long-term; the interests of a range of stakeholders (including employees, customers and the company's community and environmental impact); the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly between members of the company (**S172, UK Companies Act 2006**). Boards clearly have a key role in setting the strategic direction of the organisation. On its own the board can't deliver long-term public interest outcomes. This is a joint responsibility with the executive

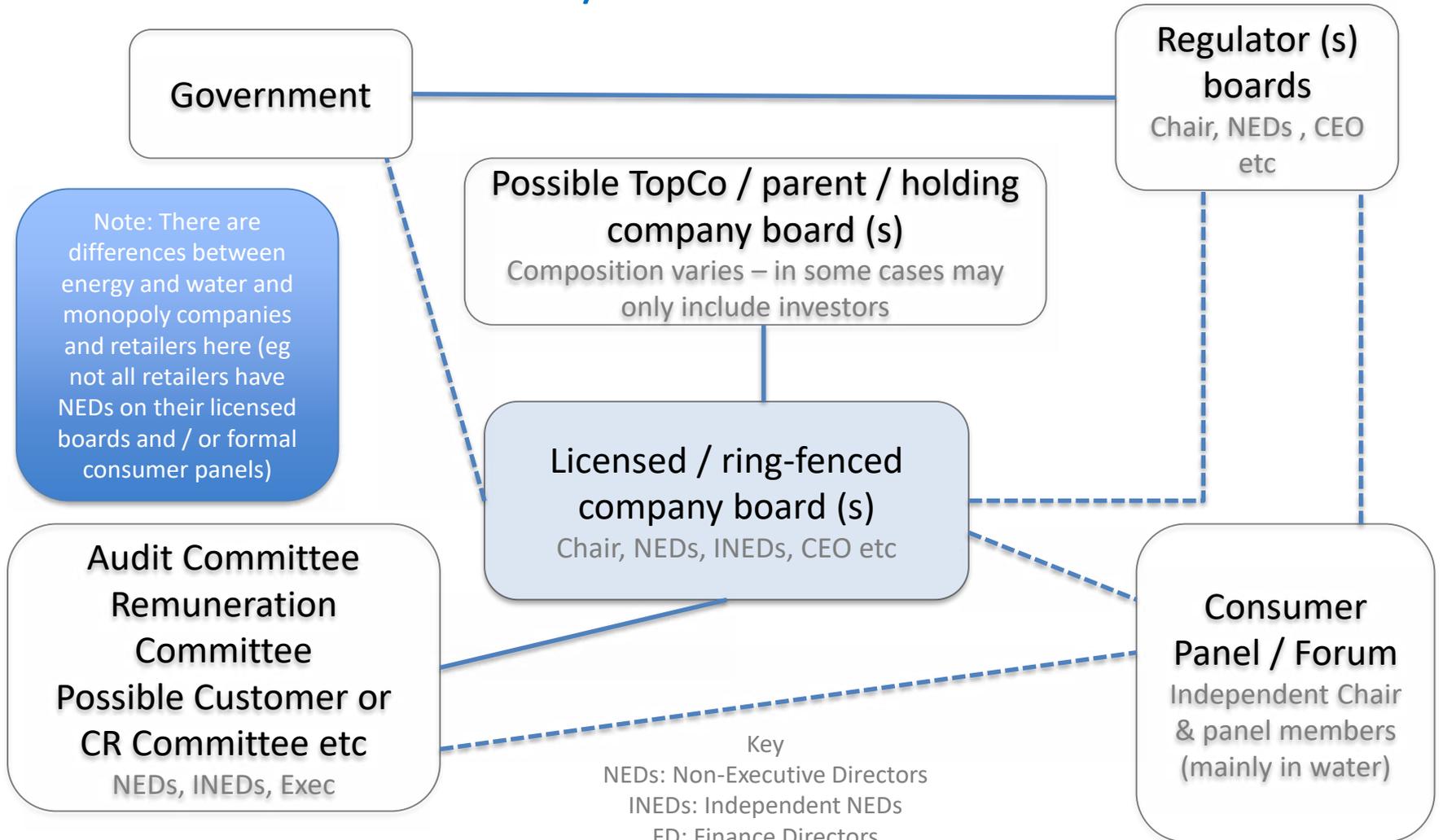
Annex 2: Definitions

Corporate structures in the energy and water sectors

- There are a mix of corporate structures in the energy and water companies operating in the UK. This check-list is aimed at the full range of ownership structures. However, some of the points raised may be more relevant to some structures than others
- A minority of energy and water companies today are Plcs – listed on the stock exchange
- Listed companies have specific formal reporting requirements (in terms of the Corporate Governance Code and holding events such as Annual General Meetings)
- Most energy and water companies are the licensed businesses of larger, often international, groups (which may / may not be listed)
- In many energy companies, the licensed businesses are accountable to the group TopCo / parent / holding company (in this slide set, we use the term TopCo for these companies)
- For illustration, the next slide provides a high-level example of a ‘typical’ generic corporate structure in the UK energy and water sectors
- The solid lines indicate a firm line of accountability. The dotted lines indicate a more informal reporting line / relationship
- In water, Ofwat licenses require the board of the regulated company to be the leading company and have full control of the business (see slide 37) – although some matters may still require TopCo / shareholder approval
- Welsh Water, a mutual, and Scottish Water, that is state owned, have slightly different group structures. The Group Structure of Welsh Water is outlined in slide 32 as an example
- It is important to note that all types of corporate structures, including not for profits, have advantages and disadvantages

Annex 2: Definitions

High level example of a 'typical' corporate structure in energy / water sectors

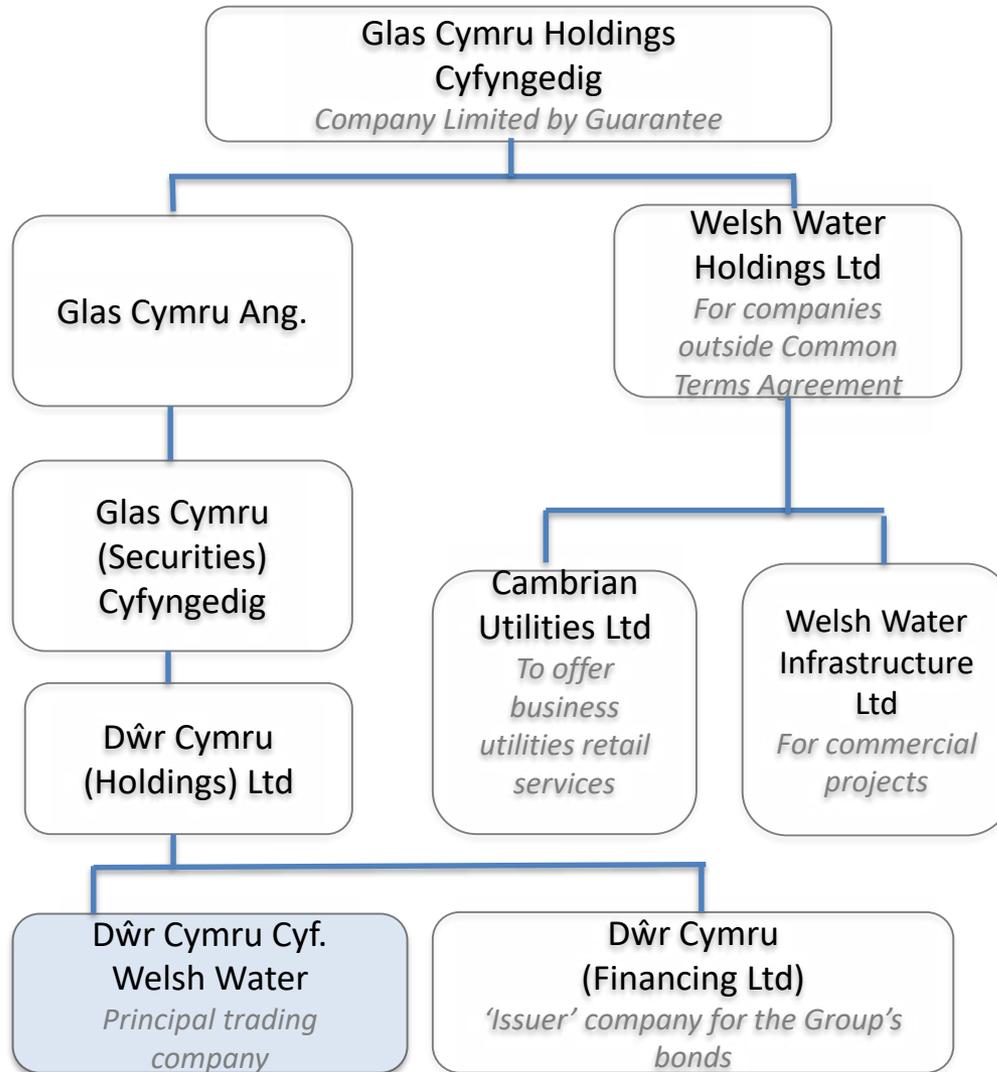


Note: There are differences between energy and water and monopoly companies and retailers here (eg not all retailers have NEDs on their licensed boards and / or formal consumer panels)

Key
 NEDs: Non-Executive Directors
 INEDs: Independent NEDs
 FD: Finance Directors
 CR: Corporate Responsibility

Annex 2: Definitions

A not for profit example - Group structure of Welsh Water



Glas Cymru members fulfil the role that shareholders would normally play in corporate governance. They attend the AGM; electing the Dŵr Cymru Board and approving their remuneration report

The members' role is to ensure that the company is focused on its primary purpose; to provide efficient high quality and affordable water and sewerage services to Welsh Water's customers, both current and future. They ensure good stewardship of the company's assets

Members are appointed by the board but selected by an independent member Selection Panel. Membership is personal; members do not represent any groups or stakeholders. Members meet formally twice a year and are unpaid

In 2016, Welsh Water engaged its customers as to how best to use the £30m that in a private company would have gone to shareholders. They received 12,000 responses; 'When people knew it was a not for profit company they were more content for the money to be used for community and environmental projects'

Annex 3 Approach and research methodology:

Research methodology for this slide set



- New-Pin's work in this area is firmly focused on UK energy and water companies and their regulators and what is distinctive in corporate governance terms for these sectors
- This slide set is based on 26 interviews with senior energy and water leaders (see next slide) and a brief literature review
- Comments were received on the draft from interviewees and New-Pin members
- The slide set clearly shows that there are differences in views and particular interests
- There are also differences between the sectors, with a more formal approach to board engagement with consumers in the water sector
- Both sectors are changing
- It takes time for cultural change to have an impact – even when it is led from the top
- We shouldn't be surprised if some of the changes in 'the way we do things round here' have yet to be reflected in the views of some of those we interviewed

Annex 3: Approach and research methodology – New-Pin governance interviews

Between November 2016 and July 2017 we have interviewed a mixture of current and past Board members



All interviews were non attributable

Annex 4: Why our specific focus on governance in energy and water

Slides 8 and 9 have highlighted why governance is important in energy & water. This slide explores some of the wider reasons why this is the case. The following two slides then outline the specific governance requirements in each sector

Trust (Edelman Trust Barometer, 1/17)

- Trust in institutions & wider systems & processes is ‘imploding’
- Barely 1 in 10 people believe ‘the system’ is working for them
- 73% agree that businesses are expected to lead

Fairness

- Brexit and the 2017 election have raised fundamental questions about how ‘fair’ our society is and how much control people want; individually, locally, nationally and globally. Boards of regulated companies providing essential services will be considering the relevance of these questions to their work
- The draft Industrial Strategy (1/17) highlighted issues of fairness between places
- Pre 2017, BEIS planned a Green Paper on ‘Markets that aren’t working fairly for consumers’ – including the energy market. That thinking is now reflected to some extent in letter from Secretary of State to Ofgem on 21st June
- NAO Report on ‘Vulnerable consumers in regulated industries’ (3/17) identified need for regulators and government to work closer together to clarify their responsibilities to support vulnerable customers
- Increasing interest in ethical business regulation (Professor Christopher Hodges, paper for BEIS 2016) and conduct regulation (Professor George Yarrow, RPI Conference, 5/17)

Annex 4: The governance landscape- Water

DEFRA

The Government's strategic priorities & objectives for Ofwat (3/17):

- Should challenge sector to plan & invest to meet needs of current and future customers, in a way which offers best VFM over long-term
- Should embed priorities & report on progress to its Board and through its Annual Report and Accounts

Ofwat – Governance Codes

Water companies need to have a Governance Code in place that they are compliant with (from 4/15). Principles:

- Reporting must be transparent
- Regulated company must act as if it is a separate public listed company
- Significant independent representation – INEDs
- Boards should have appropriate balance of skills, experience etc
- The Chair must be independent of

- management and investors
- Board committees, including audit & RemCo's, will operate at regulated company level with majority of independent members
- The group structure must be explained simply and clearly

Assessed company governance arrangements (6/15): improvements.

Separate principles for holding companies include transparency, managing risk and supporting long-term decision making: less progress.

Example - Holding Thames Water to Account

In 6/17 the Chair of Ofwat asked the company to adopt 5 commitments re: customer communication; how co. sets aspirations & performs; transparency & clarity of financial returns; board composition; & management rewards

Annex 4: The governance landscape - Energy

BEIS

- The Energy Act 2013 introduced the concept of a Strategy and Policy Statement for Ofgem
- When designated by Parliament this will 'set out the government's strategic priorities for the energy sector and the policy outcomes Ofgem needs to achieve in relation to those priorities' (Ofgem 3/16)

Ofgem

- Currently have separate governance requirements for retail and monopoly businesses

Ofgem: Retail market

- Principles Based Regulation is placing increased focus on company conduct

- In 6/17 Ofgem published its final proposals on the Standards of Conduct that sit in front of supply licences for retailers' relationships with their customers. These included a revised fairness test focused on outcomes rather than process & new principles on 'informed choices' & 'vulnerability'
- Retail boards must be ready to meet these new requirements

Ofgem: Monopoly networks

- Ring Fence Conditions in Network Operator Licenses (4/13) require operators to have two 'Sufficiently Independent' Directors where their fiduciary duties are paramount

For further information about Sustainability First, New-Pin or to get involved in our forthcoming project on '**public interest compacts**' for energy and water companies, contact

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