preventable surprises

The art of the possible:

Changing business models through forceful stewardship in the energy utility sector in 2017

"Sometimes doing your best is not good enough. Sometimes you must do what is required."

Winston Churchill

Context

A step change in ambition is needed to stop catastrophic climate change and prevent the portfolio losses that this would entail

- COP21 set a target to keep warming at 1.5°C, with an absolute maximum of 2°C (in real terms this means achieving net zero emissions by mid-century)
- PWC estimate that this means the carbon intensity per $ of output needs to reduce by 6.2% per year up to 2100 across all sectors
- The current global average is 2.9% (though per country performance varies widely)
- Rate needs to more than double to get to the target reduction

Preventable Surprises' response - drive a step change in investor action

- Investors and financial regulators recognise the systemic and unavoidable risks to portfolio value, cash flow and dividends from climate change

- The simplest thing all investors can do to support change is to vote for AGM resolutions calling for business transition plans aligned with <2°C world

- A strong vote 'for' will empower corporate change agents and specialist ESG investors who can do detailed follow up engagement. Influential intermediaries (sell side and credit rating analysts, voting advisers auditors) will be alerted to take this issue more seriously

2017 Goal: A triple leap forward in AGM resolutions:

(1) From supply side to supply and demand - major power utility customers

(2) From 2°C stress tests to <2°C compliant business models expressed in transition plans

(3) From intensive but very focused engagement to ‘industrial scale’, across sectors, starting with utilities

Why choose a sector-based approach and industrial scale?

- **Impact:** a critical mass or targets mean that all companies are on a level playing field

- **Simplicity**: universal investors may find it difficult to address climate risk with a company-by-company approach

- **Effectiveness:** transition plan guidance can be tailored to be company and sector specific

- **Complimentarity:** a focus on energy utilities complements supply side work with fossil fuel producers i.e. 2°C stress test resolutions at oil & gas companies such as ExxonMobil and Chevron

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Why choose the energy utility sector?

Timing: utilities already face structural challenges due to the energy transition –current business models no longer an option

The paradigm shift in the (electrical utility) sector... seems irreversible. The identified upside will be tough for incumbent utilities to capture, and it is rather unlikely that they will all be able to take part.

- *McKinsey Beyond the storm - value growth in the EU power sector.*

Scale: utilities are the largest GHG emitters at 28%

Opportunity: energy transition presents opportunities as well as threats

Positive role models exist (e.g. Hawaiian Electric, Next Era, DONG, ENEL, Xcel Energy Edison International/Southern California Edison)

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What did we, collectively, achieve?

- Resolutions were filed at 39% by market cap of the US utility sector
- Most resolutions were for scenarios not transition plans

2017 resolution		AGM	Filer	2016	2017
AES	Proposal 6	4/20	Mercy Investments	42.2	40.1
Ameren	Item 6	4/27	Mercy Investments	X	47.5
DTE Energy	Proposal 5	5/4	NYS Comptroller	X	45.0
Duke	Proposal 7	5/4	NYS Comptroller	X	46.4
Dominion	Item 8	5/10	NYS Comptroller	21.3	47.8
First Energy	Item 10	5/16	As You Sow	X	43.4
PPL	Proposal 6	5/17	NYS Comptroler	X	56.8
Southern	Item 6	5/24	Sisters of St. Dominic	34.0	46.0

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Lessons learned

- Investors can be persuaded that financial and ESG factors are intertwined and warrants assertive stewardship action, even mega investors like Blackrock

- Task Force on Climate Related Financial Disclosure validated the importance of seeing both together – yet 40% plus of investors still acting as bystanders/enablers

- Investors still very cautious about asking for what is needed

- Much more work needed for 2018, including public campaigning

- And then the plans need independent scrutiny, the precursor to the invisible hand of market forcing action

Conclusions

- If not us, then who?
- If not now, when?