Investor Expectations on the Just Transition: Publicly Traded Energy

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Working Paper
October, 2020

INITIATIVE FOR RESPONSIBLE INVESTMENT

Introduction: Investors and the Just Transition

Over the past several years, investors, along with stakeholders from the public, corporate, and civil society sectors, have increasingly recognized the importance of a just transition to a low-carbon economy. For investors' purposes, we can define the just transition as the integration of concerns about workers and communities into climate-related planning and activity. This requires consideration of vulnerable workers and a variety of affected communities when both addressing the challenge of stranded assets and ensuring that the substantial public and private investments in low-carbon strategies and technologies create an inclusive, sustainable economy.

These concerns are acknowledged in the Paris Climate Agreement, which acknowledges both the importance of "the imperatives of a just transition of the workforce and the creation of decent work and quality jobs in accordance with nationally defined development priorities" and the importance of "taking into consideration vulnerable groups, communities and ecosystems" when developing Nationally Determined Contributions in support of the agreement. The labor, human rights, and environmental justice issues embedded in the just transition have been articulated by organizations from the ILO to Movement Generation.

Investors – representing over $10 trillion of assets under management -- who have signed onto the Investor Statement of Commitment to Support a Just Transition on Climate Change have acknowledged their potential roles in implementing the just transition. These investors have pointed to the importance of the just transition to achieving countries' broad commitments to human rights and social dialogue. Investors understand that securing a broad political mandate for the transition to a low-carbon economy, with a meaningful voice in the process for those most affected, is essential to the success of the transition.

For investors, shareholder engagement with corporations on the just transition is one key arena for action. But to date, investor action around climate change has advanced further on carbon mitigation than on the social issues that emerge from the necessarily broad and deep economic transformation that the climate crisis entails.

In research conducted by the Initiative for Responsible Investment [IRI], and through engagement with the investment community via the IRI and the Interfaith Center for Corporate Responsibility [ICCR], the need for sector-specific guidance laying out investor expectations of corporations on the just transition has become clear. Responsible investors, in their corporate engagement strategies, rely on such sector-specific approaches to make their engagements meaningful, robust and effective. It is a path for integrating just transition concerns into existing responsible investment and climate related investor platforms.

The just transition poses a set of particular concerns for responsible investors:

There are key instrumental reasons to focus on a just transition, as **social cohesion is a precondition for achieving the rapid decarbonization** called for in the Paris Agreement, but social cohesion does not easily fit into business case analysis;

Similarly, **the transition is systemic as well as global**, and relies on economy wide analysis that builds on, but is not limited to, corporation by corporation analysis of environmental, social, and governance issues that make up conventional responsible investment practice;

The just transition raises important ethical issues about the distribution of costs and benefits involved in a structural transformation of political economic systems, requiring special attention to racial, class and gender implications in the transition;

Because **the just transition requires a focus on the political-economic system broadly**, social dialogue across key stakeholder groups is fundamental to addressing the coordination of environmental, social, and economic goals. It is important to note that not all net-zero solutions proposed are agreed by all groups;

Public policy and civic activism must play roles, with investors in supportive roles, in bringing about a just transition.

These concerns require a holistic approach to engaging corporations on the just transition, and special attention to stakeholder engagement and the direct and indirect effects of individual corporate action on vulnerable workers and communities.

The Energy Utility Sector

This paper lays out core considerations for investor expectations for the sector of publicly traded energy utilities. There are several reasons for investors to focus on the energy utility sector in their climate and Just transition investment strategies. The electric utility sector in 2018 was the second largest source of U.S. greenhouse gas emissions, accounting for 26.9 percent of the U.S. total due to fossil fuel use in electricity production. The electric utility sector will be an essential factor in decarbonizing other key sectors of the economy, primarily transportation, but potentially also building heating and cooling and cooking that rely on oil and natural gas. Any plan for decarbonizing the US economy will have to prioritize the utility sector, and significant resources will be necessary for utilities to switch to clean energy production and provision. Investors consider the utilities sector to be a significant part of the investing universe, currently representing approximatly 3% of the S&P 500 equity index and over 6% of issuance in the Corporate Bond Index year-to-date. On December 31, 2019, the 45 investor-owned utilities that belong to the Edison Electric Institute had a combined market capitalization of over $900 billion.

Further, the utility sector is tangibly embedded into a broader array of stakeholder networks that make considerations of the social consequences of decarbonization especially clear. Utilities are highly regulated, and the role played by public policy in framing choices about future production is relatively transparent, depending on the region. Utilities often employ large skilled workforces in energy production, transmission, and maintenance, with relatively high union density in comparison to other occupations, providing avenues for worker engagement. Communities both play host to utilities and comprise their ratepayers. They see the costs, effects and fairness of service delivery in their homes and on their bills; and community activists are regularly engaged in identifying the costs and benefits to different groups experiencing the externalized environmental and social costs of energy production and distribution. These externalized costs are felt directly, most often by marginalized communities, disproportionally communities of color, in the form of air and water pollution, coal ash particulates and toxic emissions from natural gas pipelines and compressor stations. Energy provision is widely understood to be a fundamental social good on which these various groups of stakeholders (policymakers, workers, and community members) have an important say.

For investors, utilities' embeddedness in stakeholder networks translates into important just transition risks over the long term.

Investors must consider: Reputational and stakeholder risks: as they shift towards low-carbon energy, utilities will face public challenges from workers, community activists, and ratepayers on the costs to stakeholders of the transition.

Political risks: utilities are closely regulated, and stakeholder pressures can drive public policy, affecting utilities' bond rating as well as their long-term financial and carbon mitigation performance.

Systemic risks: A rapid low-carbon transition necessarily involves extensive reshaping of economic activity. The unequal distribution of costs and benefits in this transition poses significant economic and social risks. Sector-specific analysis based on these risks informs the core of investors' expectations of publicly-trade utilities on the Just transition. But risks are only one side of the coin. Investors can play an active role in promoting a Just transition, in order to support systemic change that allows for investors and society to manage the transition more effectively, as well as to provide opportunities for improved and sustainable financial performance.

Investors must consider reputational and stakeholder risks, political risks, and systemic risks posed by the energy transition.

A Framework for Investor Expectations of the Utilities Sector

Investors will expect a range of disclosures from utilities on policies and processes that cover board-level governance of the just transition, particular commitments to decent work, access to jobs for marginalized communities, and support for workers and communities negatively affected, and political commitments that favor or impede the necessary transition.

Any sector-specific guidance on the just transition will draw on existing protocols for managing worker and community issues with the framework of responsible investment. Specifically, guidelines such as the ILO's "Guidelines for a just transition towards environmentally sustainable economies and societies for all," the UN Guiding Principles on Business and Human Rights, the ITUC's project on social dialogue on working conditions, and the OECD's Guidelines for Multinational Enterprises are important resources on which to draw for a sector-specific framework. **The Just Transition does not require new social guidelines so much as the integration of existing protocols on social issues into existing climate engagement strategies.**

Utilities can provide a clarifying sector for just transition engagement, because many utilities have committed to a low or net-zero carbon transition and have outlined preliminary plans to achieve those goals. While the plans vary in their ambition, with discussion centering especially on the rates at which utilities move away from fossil fuel energy, specifically coal and natural gas, on the path to zero emissions by 2050, they all involve major changes in the utilities' business models and policy frameworks that govern their business plans. The plans highlight the inevitably significant effects on ratepayers, communities, and workers that will come even from those that fall short of science-based targets for decarbonization.

Investors will expect a range of disclosures from utilities on policies and processes that cover board-level governance of the just transition, particular commitments to decent work, access to jobs for marginalized communities, and support for workers and communities negatively affected, and political commitments that favor or impede the necessary transition. These are in addition to existing expectations for a low-carbon transition that corresponds to a policy of decarbonization consonant with science-based targets.

Questions Investors May Ask

On Governance

Board-Level Policy:
Has the Board established a policy ensuring:

All workers and communities vulnerable to the impacts of the company's decarbonization plans be identified;

Appropriate mechanisms are in place to engage vulnerable workers and communities in order to solicit their concerns and perspectives;

The concerns of workers and communities are incorporated into and adequately addressed by the company's transition plans.

Accountability:
Has the Board established an accountability mechanism by identifying which board committee is responsible for oversight of the just transition process?

Has the Board linked executive compensation to decarbonization commitments?

On Utilities' Transition Plans

Transition necessitates moving away from carbon intensive energy production and distribution. When closing carbon-intensive plants, how does the utility:

Provide for retention, retraining, redeployment, or retirement support for existing workers negatively impacted by a plant closure?

Address community concerns for lost jobs, negative impacts on the local tax base, and the loss of collateral public benefits from plant closure?

Support social dialogue among public, private, and civil society stakeholders (including ratepayers and affected communities) to address the crucial issues of (1) who pays for plant closures, and (2) what systems are in place to support reinvestment for affected workers and communities?

If utilities continue to invest in new fossil fuel assets or maintenance of existing fossil fuel assets, how does the utility:

Consider the impacts on ratepayers of investments in assets whose useful life must be shortened beyond traditional depreciation timelines to meet climate goals?

Facilitate the wind down of fossil fuel-reliant systems without burdening remaining customers?

Conduct due diligence and incorporate community consultation on new renewable developments.

Investors will have related concerns about the new jobs and economic development created in the transition to low-carbon production and transmission:

What policies are in place to support decent work and quality jobs standards in the jobs created in the transition? These may include responsible contracting protocols, worker retention, wage and benefit standards, health and safety protocols and training and workforce development.

How does the utility ensure that job creation and economic development are delivered to vulnerable communities, especially to women and people of color? These may include diversity and inclusion standards, local hire provisions, and environmental justice analysis of new activities.

What steps are in place to ensure worker and community input into the creation of physical infrastructure and workforce development related to the low-carbon transition?

On Political Engagement

The private sector will need to support and align with ambitious public policy to achieve the goals of a just transition. Investors need robust disclosure frameworks that identify how utilities:

Lobby in favor or against national, sectoral, or regional policies incentivizing deep decarbonization;

Integrate distributional issues, especially those affecting vulnerable workers and communities, into their political engagement activities, for instance, by supporting policies that directly encourage diversity (e.g., by ensuring that social dialogue includes diverse voices with power from vulnerable communities by race, class and sector).

Lobby in favor or against national, sectoral, or regional funds that support workforce transition and economic development.

Align their corporate policies with national, regional, or community generated just transition plans.

Conclusion

Investors are only one stakeholder among the many necessary to effect a just transition. But they can play an important role, through stakeholder engagement, in supporting corporate practices that engender the broad political and social cohesion necessary to achieve the rapid and comprehensive low-carbon transition required by the climate crisis.

In this brief document, we propose a clear and manageable set of questions that investors can integrate into their climate engagement strategies with public-owned utilities.

We hope this document provides a framework for tailored climate engagement strategies with utilities that addresses the range of issues necessary for a Just Transition. We also hope that it prompts further sector-specific guidance that, rather than reinventing investor expectations around the climate crisis, instead draws on existing environmental and social protocols to encourage investors to take a holistic approach to other economic sectors, to achieve the broad and deep socioeconomic changes that are necessary to achieve a just, low-carbon transition in line with the needs of people and the planet.

Acknowledgments

The authors would like to give a special thanks to the following for providing feedback:

Lila Holzman, As You Sow
Laura Campos, The Nathan Cummings Foundation
Valerie Boucard, The Nathan Cummings Foundation
Cristina Cedillo Torres, Robeco
Kimberly Stokes, Calvert
François Meloche (Æquo), Bâtirente
Francis Sherman, Seventh Generation Interfaith Coalition for Responsible Investment
Jake Barnett, Wespath Benefits and Investments
Kate Monahan, Friends Fiduciary
Mary Beth Gallagher, Investor Advocates for Social Justice
Jillianne Lyon, Investor Advocates for Social Justice
Eli Kasargod Staub, Majority Action
Christina Herman, ICCR
Samir Jagdish, ICCR
Emily Anne Garfunkel, ICCR

The authors would also like to thank the many people who were interviewed and shared insights that contributed to this report.

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The Initiative for Responsible Investment (IRI) is part of the Hauser Institute for Civil Society, Center for Public Leadership at the Harvard Kennedy School. The IRI serves as a platform for dialogue on fundamental issues and theories underlying the ability of financial markets to promote wealth creation across asset classes, while creating a stonger society and a healthier environment. The IRI works across asset classes to build communities of practice around innovative concepts in responsible investment, promoting the development of the theory and practice of responsible investment through research, dialogue, and action.