ENERGY TRANSITION

CORPORATE RESPONSIBILITY NET ZERO DECLARATIONS PROVE A MINEFIELD

The c-suites increasingly turning to net zero disclosures are entering a confusing and high-risk field

Key takeaways

- For large multi-national companies, the pressure to make substantive environmental carbon neutral declarations will be increasingly hard to resist
- Lack of agreed standards in net zero or carbon neutral reporting mean c-suites will have to apply careful judgement and craft flexible strategies that can evolve
- Environmental or carbon-based declarations lacking credibility will increasingly attract reputational, regulatory and investor blowback

If man-made climate change has been a reality for decades, CEOs and boardrooms could be forgiven for failing to keep up with the startling recent pace of change in an area that has rapidly lurched from empty corporate platitudes to high-stakes strategic commitments. Buoyed by the 2015 Paris Agreement, plunging costs of renewable power and increasing support for green policies from Western consumers, the terms of the climate change debate have shifted beyond recognition in the past five years.

From a plc perspective, nowhere is the urgency of the green agenda more visible than in the dash to issue net zero or carbon neutrality declarations, spelling out companies' policies on slashing carbon footprints. The rollcall of major firms to have made such announcements over the last two years is remarkable, with the UN last September noting that corporates with a combined revenue exceeding $11.4trn have made public commitments to go net zero. Marquee firms that have committed to net zero emissions before 2050 or earlier include Microsoft, Shell, Land Securities, AstraZeneca, Sainsbury's, BP, BT, British Airways, Barclays, Total, Unilever and Apple, and the list is lengthening by the day.

Indeed, many major companies are seen as going further than most Paris Agreement signatory nations, which are currently far short of making the kind of commitments that will achieve the headline aim of holding climate change to a 1.5-degree rise above pre-industrial temperatures. Even those companies inclined to corporate realpolitik have to contend with an investment community increasingly applying pressure for both greener policies and substantive disclosure of listed firms' environmental impact, not to mention a rash of sustainability-focused regulation at a national level. As Peter Zaman, a commodities and climate finance expert at HFW, notes: "Shareholder activism is today forcing a lot of companies to react in response to that pressure by declaring themselves as willing to set net zero or carbon neutral objectives or have net zero ambitions. That pressure from asset managers have become intense specifically during the last three years and definitely more so following the pandemic."

Such dynamics were apparent even before the new Biden administration this year took the US back into the Paris accord, bringing the world's largest economy back to the table, while the EU's Green Deal looks set to further drive policy in another key regional bloc.

But if such factors demand a clear response from companies priming their net zero or carbon neutral policies and disclosures, the realities on the ground make such objectives much harder to implement. Like an unpredictable field of conflict, companies trying to craft their green declarations face an environment that is developing, mostly unregulated, fast-moving and confusing, where numerous parties jostle for strategic

"At the extreme you could have corporates arbitraging between various net zero vs carbon neutrality standards in an attempt to walk the tightrope between being seen to do something vs the criticism for not doing it."

advantage. The primary cause of such difficulty is that this inherently global issue is still being tackled largely at a voluntary rather than mandatory or regulated level. Whether setting a benchmark for investors to judge green investments, establishing accounting frameworks or forging standards for net zero declarations, competing yardsticks are now being issued at a frenetic pace, giving corporates too many choices with no steer on the relative merits of the most suitable for their business or sector.

This leaves companies with the challenge of ascertaining what polices to implement and which disclosure regime to apply in an area in which there is much change and little agreement. Even if a company is intent on making fulsome disclosures on green policies, a firm's direct emissions (dubbed scope 1 emissions), its purchased electricity, heat and power (scope 2) and the impact of its supply chain (scope 3) require a significant investment to map, calculate and then determine how best to reduce to the declared level. In the case of supply chain emissions, that responsibility for reducing their emissions arises in circumstances where the corporate lacks control over its suppliers and their chain. Unsurprisingly, influencing or mitigating carbon emissions for purchased energy and supply chain is a more complex business, when credible green options may not be available in some markets or suppliers are uncooperative. And that is before accounting for the challenge of which standard of declaration you adopt (many companies can't appreciate the significant differences between net zero and carbon neutral approaches). Some standards like the Science Based Targets initiative (SBTi) methodology do not allow for carbon offsetting other than in respect of Scope 3 emissions and even that, only via carbon removal offsets and not carbon reduction offsets (such as REDD+). Presently, there are not enough carbon removals to supply the needs of the corporate claims. The long-term direction of travel aligned with the Paris Agreement requires moving away from using carbon reductions in favour of using carbon removals. Other Standards do not adopt the position of the SBTi and recognise the absence of a supply of carbon removals today and the need to allow room for high quality carbon reductions to play a role in the interim.

For now, argues Zaman, the absence of agreed international standards means that many companies will pick the wrong standard for the type of business they are. "At the extreme you could have corporates arbitraging between various net zero vs carbon neutrality standards in an attempt to walk the tightrope between being seen to do something vs the criticism for not doing it. If you are being seen to do something, is it good enough? And if it isn't good enough, according to whom? That is the world that every CEO and board of directors is going to have to navigate over the course of the next few years."

If all this is enough to make the most green-minded executive want to leave the planet to fend for itself, Zaman points out some practical approaches to help address what will undoubtedly be a huge strategic challenge for years to come. Notably, company stances on crafting green disclosures have to be:

- Pragmatic – recognising commercial realities and substantial short-term challenges and trade-offs
- Flexible – meaning that green disclosures should be explicitly built to easily evolve with changing commercial, investment and regulatory dynamics
- Defendable – recognising that a growing number of investors, campaigners and agencies will be pouring over such disclosures

"My advice to most clients is there's probably no one right answer out there now but there are certain things that look and smell more like greenwashing and things that feel more Rolls-Royce in standard. For practical reasons, the right answer sits somewhere in the middle but it's a judgement call you will have to make on an informed basis because you can bet your bottom dollar you're going to have to defend it. Either you defend it to the asset manager that owns your shares, or to the regulator or the NGOs who are putting you to shame in the press. It has to be a defendable approach and, therefore, it must be reasoned, rational and appropriate for the time and it must recognise that it will have to evolve. It's such a fast-paced market that opinion on what is sufficient from a carbon neutral or net-zero perspective is changing almost daily."

That rapid change seems to be about the only thing companies can count on, that and the probability that countries will increasingly turn to regulatory sticks to drive further change in corporate behaviour. Zaman concludes by warning against the fads that have previously plagued investor and corporate behaviour in the ESG field. "You've got to make your position on an informed basis." This is a really complex area and some people really do not appreciate what they are signing up to. This is a minefield if you are a CEO or board having to make these decisions, therefore embracing the challenge of this area is an unfortunate but necessary step for a lot of companies going forward."

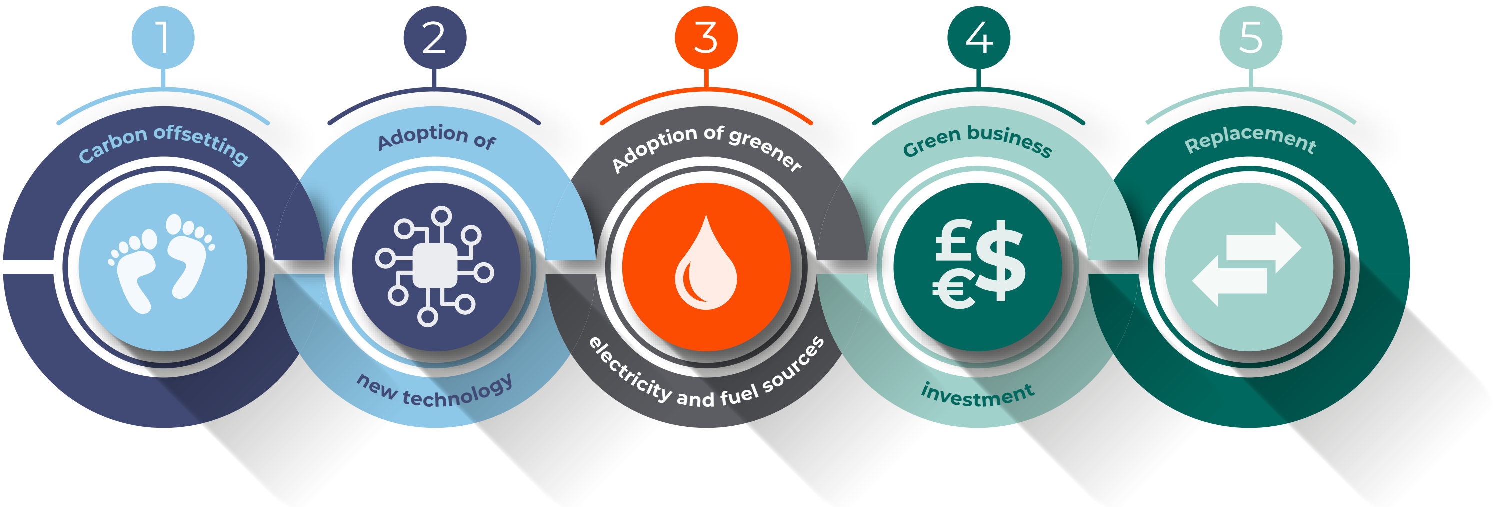
Well, no one said saving the planet was easy.

For more information, please contact;

PETER ZAMAN
Partner, Singapore
T +65 6411 5305
M +65 8511 0250
E peter.zaman@hfw.com

JO GARLAND
Partner and Energy Transition Lead, Perth
T +61 (0) 8 9422 4719
M +61 (0)428 598 615
E jo.garland@hfw.com

Find out more about energy transition by clicking below.



We are committed to using our legal and sector expertise, networks and corporate responsibility initiatives to enable sustainable practices across all of our operations and the industries that we service, and to drive meaningful and lasting change. Please visit our dedicated sustainability hub www.hfw.com/Sustainability-hub.