



ISSUE 144

BOARD PERSPECTIVES

IS YOUR COMPANY PART OF THE ENERGY REVOLUTION?

Informed organizations in all industries are establishing carbon emissions reduction and net-zero carbon emissions targets. Directors' conversations on strategy have an important role in businesses' energy transformations.

Energy consumption is a priority. The introduction of renewables continues as costs decline. The percentage of electricity consumed through non-fossil fuel sources — solar, wind, nuclear and hydroelectric energy — in the total energy consumption mix is growing. The Biden administration has made climate change a priority as other countries all over the globe embrace green energy. Sustainable investments driven by the screening criteria of institutional investors and asset managers are on track to represent more than one-third of the projected total assets under management by 2025.¹ And, as the influence of millennials increases in the

market, so does that of consumer preferences for doing business with companies committed to the well-being of the environment. Talent is migrating to those companies, too.

The bottom line is that management teams in all companies — including those that aren't energy producers — need a strong narrative for the street based on clear objectives and results. As more robust environmental and other disclosure requirements shed greater transparency on the impact of a company's activities on the environment relative to its peers, leaders should ensure that appropriate policies, processes and systems are in place, targets are set, effective plans for achieving

¹ "ESG Assets May Hit \$53 Trillion by 2025, a Third of Global AUM," by Adeline Diab and Gina Martin Adams, Bloomberg Intelligence, February 23, 2021: www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.

those targets are established, and people with the requisite knowledge and skills are in place to execute the plan along with metrics and measures for monitoring progress.

Simply stated, every organization should consider green energy consumption in its strategic plan and establish clear accountability for results. And, just as important, the energy consumption strategy merits the board's attention. Without a doubt, energy producers generate the lion's share of global industrial greenhouse gas (GHG) emissions. But "non-energy companies" — companies other than oil and gas and power firms — aren't getting a pass. Non-energy company boards should consider the action items below to better prepare for the energy revolution:

Be cognizant that more climate-related disclosures may soon be required to meet the needs of investors. Nearly two-thirds of the companies in the Russell 1000 Index and 90% of the index's 500 largest companies published sustainability reports in 2019 using various third-party frameworks.² According to Gary Gensler, the chair of the U.S. Securities and Exchange Commission (SEC), the Commission is focused on increasing the consistency and comparability of climate disclosures and is set to propose a new mandatory climate risk disclosure rule for consideration by the end of the year.³ At this point, non-energy companies have to assume they will fall under the SEC's mandate.

Encourage dialogue around the significant innovation opportunities in the marketplace. As the energy landscape changes, there may be significant opportunities in the market for entrepreneurs to create value. Boards should ascertain whether strategies and business models

are being updated to address the changing energy landscape.

For example, technology companies are deploying emerging and existing technologies to offer programmable, energy-efficient smart devices to consumers and to commercial and industrial companies. These devices, which include thermostats, water heaters, refrigerators and other Internet of Things (IoT) applications, are combined with cloud computing to collect, analyze and present in real time the owner's mountain of energy use data.

Installation of electric vehicle (EV) chargers in company parking lots, LED light bulbs and eco-friendly mobile chargers are other examples of how companies are exploiting the energy transformation.

Recognize that it takes talent to implement new models. Thinking out of the box can identify opportunities to exploit the energy transformation through new business lines. But it can also drive increased demand and competition for people with skills related to all areas of sustainability and renewables, from engineering to accounting.

As more companies focus on the energy transition, increased competition is expected for energy-related skills at non-energy companies, particularly those with large carbon footprints, such as airlines, shipping and delivery companies, and automotive manufacturers, to name a few. Adding to the challenge is the tremendous strategic battle for talent — people are increasingly joining organizations with which they can align their values.

² "65% of the Russell 1000® Index Published Sustainability Reports in 2019," Governance & Accountability Institute, Inc., 2020: www.ga-institute.com/research/ga-research-collection/flash-reports/2020-russell-1000-flash-report.html.

³ "Prepared Remarks Before the Principles for Responsible Investment 'Climate and Global Financial Markets' Webinar," SEC Chair Gary Gensler, July 28, 2021: www.sec.gov/news/speech/gensler-pri-2021-07-28.

Inquire after plans for adjusting to market trends when deploying financial capital into renewable energy. How are evolving energy markets altering the company's cost structure? How can the company shift the mix of energy consumed in its operations to increase the emphasis on green energy sources? Energy consumption should be tied to key metrics, from profitability impact to environmental, social and governance (ESG) ratings. With increasing concerns over carbon emissions, organizations want to be viewed as contributing to the solution rather than being part of the problem.

For example, nearly 40% of global carbon emissions come from buildings and construction, highlighting the need for decarbonizing air conditioning, improving insulation, and increasing the efficiency of lighting, heating and cooling systems.⁴ Lessees can't take a laissez-faire approach; they should review the energy efficiency of their facilities with proactive plans for improvement in the coming years.

Only about 20% of the energy consumed across all industries is powered by electricity.⁵ This opens up a strategic conversation to which boards can contribute around the sourcing and deployment of capital. Directors should inquire of management's focus on increasing electric-powered consumption by working with utilities to supply relatively low-cost power and with policymakers to provide supportive regulation.

And investors and lenders are increasing their portfolio allocations to companies with compelling sustainability strategies.⁶ For example, Bank of America has set a \$1 trillion goal of financing for projects and investments to reduce carbon emissions

and address other environmental needs across all sectors and, in particular, high-emitting sectors by 2030.⁷

Encourage periodic reviews of operating practices that have a marked impact on energy consumption. The pace of change requires a constant focus on operating practices rather than occasionally calling a timeout or debriefing annually. In addressing the growing ESG expectations of customers, investors and regulators, directors should ask management to consider revisiting default assumptions related to the refresh cycles of both office and manufacturing facilities and equipment as well as long-standing business practices.

Periodic "consumption audits" can raise questions that should be considered. For example, should all laptops be replaced every year? Can planned facilities expansion be postponed or canceled now that the pandemic has proven that work-from-anywhere options are viable? Is it necessary to return business travel to pre-pandemic normals? Must everyone return to the office, resulting in congested energy-consuming commutes? Needless to say, as companies address these and myriad other questions, they can drive meaningful reductions to selling, general and administrative costs.

As for energy procurement, non-energy businesses focused on making progress toward a net-zero carbon future are purchasing renewable electricity from their power suppliers or independent clean power generators, or through renewable energy certificates. Corporate buyers in steel, heavy machinery, technology, retail grocery and other industries are undertaking this strong sustainability play.⁸

⁴ "How to Slash Buildings' Growing Greenhouse Gas Emissions," by Justine Calma, *The Verge*, December 16, 2020: www.theverge.com/22178481/buildings-greenhouse-gas-emissions-climate-change-united-nations-report.

⁵ "Plugging in: What Electrification Can Do for Industry," by Occo Roelofsen, Ken Somers, Eveline Speelman and Maaik Witteveen, McKinsey, May 28, 2020: www.mckinsey.com/industries/electric-power-and-natural-gas/our-insights/plugging-in-what-electrification-can-do-for-industry.

⁶ "Green Finance Is Now \$31 Trillion and Growing," by Reed Landberg, Annie Massa and Demetrios Pogkas, Bloomberg, June 6, 2019: www.bloomberg.com/graphics/2019-green-finance/.

⁷ "BoFA Ready for Tough Conversations With Clients to Hit ESG Goals," by Harry Terris, S&P Global Market Intelligence, August 16, 2021: www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/bofa-ready-for-tough-conversations-with-clients-to-hit-esg-goals-66038213.

⁸ "The Latest Trends in Renewable Energy Procurement," by Sarah Golden, GreenBiz, May 7, 2021: www.greenbiz.com/article/latest-trends-renewable-energy-procurement.

Learn and stay informed about evolving energy policy. In the United States, several bills creating benefits and financing for carbon capture, use and sequestration have been introduced in Congress and have bipartisan support.⁹ While starting as a market expectation, carbon capture could become a regulatory requirement. Yes, there is the possibility of a carbon tax in the future, but smart boards should be concerned about the more likely scenario of an “invisible carbon tax” — the increased cost across an enterprise resulting from newly required investments, higher debt service costs, additional capital expenditures and other activities related to the energy transformation.

For example, companies are investing in on-site distributed energy resources (DERs) to provide a stable energy source in an increasingly volatile power market. To illustrate, the grocery chain H-E-B installed its own power source systems. In one city, it built and now operates its own solar energy system that connects 62 buildings. This practice could become common for companies with operations spanning multiple facilities.

Carbon capture and use technologies also have become part of the conversation for achieving net-zero-carbon emissions. Carbon capture, either through direct air capture or point source carbon capture and storage, is making it possible to use carbon for alternative purposes instead of releasing it into the atmosphere. For example, captured carbon is being used in large-scale emissions processes, including natural gas processing, fertilizer, chemicals and jet fuels production, as well as in manufacturing industrial materials such as cement, plastics, iron and steel, and pulp and paper.

View improving supply chain agility and resilience as a risk conversation, with a potential energy play as a byproduct. The issues around the Suez Canal blockage, the shipping logjam in San Francisco and other pandemic-induced supply shortages call even more attention to the interdependence and fragility of global supply chains. Scarce raw materials tend to be overly concentrated in a few areas of the world, including those that are either politically unstable or potentially unfriendly. These developments create incentives for alternative solutions that reduce dependence on these materials. They also lead to assessments of reshoring and near-shoring options. As companies explore these options, they should also consider the impact of compressing supply chains on the company’s carbon footprint.

Finally, focus on the parallel tracks of evolving security and privacy risks. The rise in electrification — the so-called electrification of everything — is opening the door to a rise in security and privacy risks as it expands a company’s exposure to the electricity ecosystem. As more things go electric, the use of technology and the variety of technologies deployed increase. This adds more ways for companies to be vulnerable to breaches, leaks and hacks, adding yet another dimension to the boardroom conversation on security and privacy risk.

Everyone knows that energy companies worldwide are under pressure to alter their strategies and business models to accommodate expectations of activist investors, demanding consumers and governments mandating emissions targets. But the above commentary suggests that there is also a robust conversation in the boardrooms of non-energy firms around energy transformation.

⁹ “Carbon Capture Bills Gathering Steam in Congress,” by Lisa Whitley Coleman, EHS Daily Advisor, June 30, 2021: <https://ehsdailyadvisor.blr.com/2021/06/carbon-capture-bills-gathering-steam-in-congress/>.

Questions for Boards

Following are some suggested questions that boards of directors may consider, based on the risks inherent in the company's operations:

- Do we have a strategy and plan for maximizing the cost, market and reputational advantages of green energy sources? Is management sufficiently focused on sustainability and climate issues? Is there an executive team sponsor? Are we reporting on progress and are relevant metrics included on the CEO's dashboard?
- What metrics and data are we reporting to the street around energy utilization and efficiency and the reduction of our carbon footprint? And do our reports convey our progress? With respect to the energy consumption goals and targets we have committed the organization to pursue, what execution plans have we established and how have we set accountability for results across the company through metrics, measures and monitoring? What frameworks are we using to guide our disclosure practices? Has investor feedback confirmed the value of our disclosures and whether our strategy is resonating with the investor community?

How Protiviti Can Help

Protiviti's experienced professionals help utility, pipeline and transmission companies identify, measure and manage their regulatory, financial, operational and technology-related risks. Our energy professionals have finance, technology, accounting and engineering backgrounds, and a wide range of industry experience. We bring this

expertise to your organization through unmatched collaboration, creating custom solutions that fit your business and help you face the future with confidence. We also help non-energy companies with adapting to the evolving energy transformation in the marketplace.

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