Grantham Research Institute on Climate Change and the Environment

Centre for Climate Change Economics and Policy

Consultation response: 'Streamlined energy and carbon reporting'

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Consultation response: 'Streamlined energy and carbon reporting'

Introduction: what is this consultation about?

The question of how companies should disclose climate change risk to their investors is receiving an increasing amount of attention. Listed companies in the UK are already required to disclose environmental, social and governance (ESG) considerations under the UK Companies Act. Starting from 2017, the UK's adoption of the EU Non-Financial Reporting Directive means certain non-listed companies with more than 500 employees will also be required to make disclosures about environmental matters. However, disclosure of climate risks – both transitional and physical – could be applied both more generally (expanding the reach of climate disclosure) and uniformly (standardising the disclosures).

The Government is seeking views on its proposal for a more streamlined and effective energy and carbon reporting framework. This paper sets out responses to selected questions by the ESRC Centre for Climate Change Economics and Policy and the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science. This consultation response was first submitted via the CitizenSpace online platform.

Recommendations

Q3. Do you agree that reporting should be done through annual reports? [Yes or No] Please explain your answer. If yes, would any of the following, forming part of companies' annual reports, be better suited? a) Directors' reports, b) Strategic reports, or c) a new, bespoke report. Please explain your answer, note any issues you see with using these reports, and provide any comments on how proposals might best fit within the annual reports regime.

Response: As noted by the recommendation of the Task Force on Climate-Related Financial Disclosures (TCFD), disclosure in mainstream financial filings could foster shareholder engagement, ensure that appropriate controls govern the production and disclosure of the information, and would be more likely to be reviewed by the chief financial officer and audit committee than a supplementary document would be (TCFD, 2017). Including carbon accounting within the 'strategic' section of the annual report could highlight the issue as a strategic priority with associated key performance indicators (KPIs) that are tracked over time, and climate change risk more generally could be incorporated into risk management, if not already there.

This data should be transparent and comparable in order to be useful for investors (TCFD, 2017). This means having sufficiently detailed information to understand how the reported numbers were calculated. That information could come either from the annual report itself, or from a supplementary document, or a standardised reporting template that outlines the methodology. The Grantham Research Institute's research on the Transition Pathways Initiative (which assesses how individual companies are positioning themselves for a transition to a low-carbon economy) suggests there is currently considerable heterogeneity in how firms calculate and report data on emissions and carbon intensity, which makes it difficult for investors to compare companies (see Question 12).

If a firm uses its own methodology, it would be useful for the firm to include how it computed and reported the relevant metrics, e.g. if it included Scope 1, 2, and 3 emissions, or how it calculated carbon intensity.

Reference for Q3:

TCFD, 2017. *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures.* Available from: https://www.fsb-tcfd.org/publications/final-recommendations-report/

Q5. Do you agree that the government should seek to establish a mechanism for collating published energy and carbon data for example via a central published report or tool? Please explain your answer.

Response: We agree that it would be helpful to have a central repository as this data is a public good for both investors and researchers. Currently, private data providers often put limitations on access to data, so by providing a central repository, access would be improved.

Q6. Do you think that the policy should apply to:

A. all 'large' companies based on employee numbers and financial tests;
B. companies who meet the 6GWh ex-CRC annual electricity use threshold described; or
C. another threshold?

Please explain your answer. Please state if you have any views on whether reporting should be required to operate at the group or individual company level.

Response: From the perspective of data availability for researchers, it is important that large emitters are covered under the threshold. A combination of reporting under the EU emissions trading system (ETS) and the 6GWh threshold (B) would include large emitters that also produce their own electricity. However, the reporting framework should make sure that they will continue to be covered by reporting guidelines in the event that the UK's participation in the EU ETS changes. It would be useful for the reporting framework to ensure the data is available at company level as well as asset level for companies that are reporting under the ETS.

Q9. Should reporting requirements within the Companies Act regime also apply to Limited Liability Partnerships (LLPs)? [Yes or No]. Please explain your answer.

Response: From the perspective of data availability for researchers, it would be useful to have large emitters included, regardless of the form of corporate governance.

Q10. Please state where you agree that UK quoted companies should continue, or start to report, on one or more of the following a) global Scope 1 and 2 GHG emissions b) an intensity metric, and start to report on c) global total energy use? Please also provide any views and evidence on the effectiveness of the current mandatory GHG reporting regime in improving corporate transparency, reducing energy use, and reducing emissions.

Response: To be able to compare across companies, it would be useful to have Scope 1 and 2 emissions as well as intensity. Without an intensity metric, it is difficult to compare companies: the emissions data needs to be normalised by the size of the firm so that it can be benchmarked in a way that absolute emissions cannot be.

This raises the question, however, as to how intensity should be calculated. The numerator should include the scope of emissions that are relevant to the sector of activity. In some sectors, Scope 1

emissions are the most relevant (e.g. Electric Utilities, Cement); in other sectors it is the sum of Scope 1 and Scope 2 emissions that matter most (e.g. Steel, Aluminium, Paper & Pulp); and in yet other sectors Scope 3 emissions associated with the use of products are the predominant form of emissions (Fossil Fuel Extractors, Automakers) (Raynaud, 2015; Sullivan et al., 2017).

Calculating the denominator also raises questions. A widespread method is to use revenue (i.e. carbon emissions per unit of revenue, expressed in monetary units). However, this may be problematic because of price and foreign exchange volatility, as well as pricing discrepancies between firms: for example, products that are similar but sold at different price points (Raynaud, 2015). The Grantham Research Institute's online tool for assessing companies' positioning for a transition to a low-carbon economy, the Transition Pathway Initiative, instead uses sector-specific production metrics, such as GWh of electricity produced, tonnes of product (e.g. crude steel, cementitious product), or kilometres travelled (Sullivan et al., 2017). This works better for some sectors than others: for example, there are challenges in the chemical sector, where tonnes of different types of chemicals are not equivalent in terms of their carbon intensity.

We would recommend, therefore, that intensity per unit of revenue be included at a minimum, and carbon intensity per unit of production also be included where relevant and feasible.

References for Q10:

Raynaud, J., 2015. *Carbon Compass: Investor guide to carbon footprinting.* London: Kepler Cheuvreux. Available from: http://www.iigcc.org/publications/publication/investor-guide-to-carbon-footprinting

Sullivan, R., Dietz, S., Carlota, G.-M., Matthews, A., Ward, F., 2017. *Methodology and Indicators Report.* London: Transition Pathways Initiative. Available from: http://www.lse.ac.uk/GranthamInstitute/tpi/wp-content/uploads/2017/01/Methodology.pdf

Q11. Do you agree that UK unquoted companies in scope should report on a) total UK energy use, b) Scope 1 and 2 GHG emissions associated with UK use c) an intensity metric? Please explain your answer. Do you agree that only electricity, gas and transport energy should be in scope for unquoted companies? [Yes or No]. Please explain your answer, and if no please set out what you think the scope should be.

Response: In accordance with Q9, we agree that it would be useful to have data on large emitters, regardless of whether they are listed or not.

Q12. Should the government a) mandate the use of specific intensity metrics by sector; b) propose best practice in any guidance; or c) leave the matter to sectors, and to existing best practice and guidance?

Response: Existing voluntary disclosures are inconsistent and incomplete (Weber et al., 2017; Climate Disclosure Standards Board, 2016). Research for the Transition Pathway Initiative has also shown a great deal of variability within sectors in how they report on carbon emissions. For example, cement producers have created the Cement Sustainability Initiative voluntary reporting guidelines, but they are followed by only 10 out of the 19 largest cement producers (Dietz et al., 2017a). Many other sectors lack voluntary guidelines in general, resulting in heterogeneous reporting of intensities. In the steel sector, for instance, those companies that do report intensities use such varied denominators as 'crude steel', 'raw steel', 'liquid steel', 'melting output', 'steel', 'steel products', 'products' – or sometimes simply 'tonnes'. Because these refer to different stages of the

steelmaking industrial process, the consistency of the intensities disclosed by companies suffers (Dietz et al., 2017b).

Mandatory reporting could have value by increasing the number of firms participating and helping to increase the consistency of disclosure.

References for Q12:

Climate Disclosure Standards Board, 2016. *Comply or explain: A review of FTSE 350 companies' environmental reporting and greenhouse gas emission disclosures in annual reports.* London: Climate Disclosure Standards Board

Dietz, S., French, E., Garcia-Manas, C., Irwin, W., Jackson, P., Rauis, B., Sullivan, R., Sung, J., 2017a. *Management quality and carbon performance of cement producers: a commentary.* London: Transition Pathway Initiative. Available from: http://www.lse.ac.uk/GranthamInstitute/tpi/wp-content/uploads/2017/09/Cement-combined-report-21-Sept.pdf

Dietz, S., Garcia-Manas, C., Irwin, W., Rauis, B., Sullivan, R., Sung, J., 2017b. *Management quality and carbon performance of steel makers: A commentary.* London: Transition Pathways Initiative. Available from http://www.lse.ac.uk/GranthamInstitute/tpi/wp-content/uploads/2017/09/Steel-combined-report-21-Sept.pdf

Weber, C., Dupre, S., Thomae, J., Braschi, T., 2017. *Asset-level data and climate-related financial analysis: a market survey.* Paris: 2 Degrees Investing Initiative. Available from: http://2degrees-investing.org/IMG/pdf/assetdata_v0.pdf

Q13. A) Do you think it should be mandatory for UK quoted and unquoted companies in scope to include information from the most recent audit (including energy management systems such as ISO50001) on i) any identified energy savings opportunities [Yes or No] and ii) any energy efficiency action taken? [Yes or No]

Encouraging energy efficiency can reduce energy consumption and, by extension, carbon emissions (Committee on Climate Change, 2017). Therefore we would support reporting insofar as it helps with the monitoring and reduction of the overall level of emissions.

References for Q13A:

Committee on Climate Change (2017) Energy Prices and Bills Report 2017. London: Committee on Climate Change. Available at: https://www.theccc.org.uk/wp-content/uploads/2017/03/Energy-Prices-andBills-Committee-on-Climate-Change-March-2017.pdf

B) Building on the energy and carbon disclosures proposed here, please provide views on whether in the long-term any of the TCFD recommended voluntary disclosures should become mandatory disclosures within companies' annual reports.

The academic literature suggests that voluntary reporting alone may not be enough because companies do not have a sufficient incentive to disclose comparable and reliable data for users (Harmes, 2011; Sullivan and Gouldson, 2012; Andrew and Cortese, 2011).

Research for the Transition Pathway Initiative at the Grantham Research Institute supports the view that voluntary disclosures may not be sufficient for widespread and consistent disclosure. For example, out of 3,208 global listed companies active in the GICS Energy, Electric and Multi-Utilities and Auto & Components sectors, in 2016 only 329 reported Scope 1 and 2 emissions, and only 98 of

those reported the Scope 3 emissions associated with use of products. For British companies, the equivalent numbers are 129 listed companies, with 25 disclosing Scope 1 and 2 emissions and five of those disclosing Scope 3 emissions associated with the use of their products (from Bloomberg data, obtained June 2017).

In addition to carbon intensity and scenario analysis, the TCFD (2017) also recommends that companies disclose how they incorporate climate change into their risk management and governance frameworks. Reporting carbon disclosures is important information for investors, but it would also be useful information for investors to know how companies are considering climate change risks more generally (e.g. transition risk from technological change or physical impacts of extreme weather events).

References for Q13B:

Andrew, J., Cortese, C., 2011. Accounting for climate change and the self-regulation of carbon disclosures. *Accounting Forum,* 35, pp.130-138.

Harmes, A., 2011. The limits of carbon disclosure: Theorizing the business case for investor environmentalism. *Global Environmental Politics,* 11, pp.98-119.

Sullivan, R., Gouldson, A., 2012. Does voluntary carbon reporting meet investors' needs? *Journal of Cleaner Production,* 36, pp.60-67.

TCFD, 2017. Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures. Available from: https://www.fsb-tcfd.org/publications/final-recommendations-report/

C) Please specify what support government could provide to support uptake of TCFD disclosures by companies from all sectors.

Sullivan and Gouldson (2012) suggest that mandatory disclosure could be beneficial in increasing disclosure but may not be sufficient in and of itself for making sure that the data disclosed is useful and comparable. Besides mandatory disclosure, the Government could develop or support the development of a common set of climate scenarios and best practice guidelines on a sectoral level.

Reference for Q13C:

Sullivan, R., Gouldson, A., 2012. Does voluntary carbon reporting meet investors' needs? *Journal of Cleaner Production,* 36, pp.60-67

D) Reporting of what other complementary information would add most value for businesses, the market and other stakeholders?

It would be helpful to have some insight into companies' future plans and carbon intensity, in addition to backwards-looking data on historical emissions (Weber et al., 2017). For example, it would be helpful to have a breakdown of the proportions of their sales, capital expenditures and research and development expenditures that are related to 'green', 'neutral' and 'brown' activities, as well as their methods for determining what activities are 'green', 'neutral' and 'brown'.

Reference for Q13D:

Weber, C., Dupre, S., Thomae, J., Braschi, T., 2017. Asset-level data and climate-related financial analysis: a market survey. Paris: 2 Degrees Investing Initiative. Available from: http://2degrees-investing.org/IMG/pdf/assetdata_v0.pdf

Q18. Do you have any other comments on the description of how potential future enhancements to energy and carbon reporting might function under any of the possible approaches, have other suggestions for future enhancements, or consider that any aspects of energy and carbon reporting proposed for 2019 might be better deferred? Please explain your answer.

We emphasise again the importance of reporting Scope 3 emissions for some sectors for whom reporting Scope 1 and 2 alone would be inadequate. In particular, transport (vehicle manufacture) and fossil fuel extraction should report Scope 3 emissions from sold products (Raynaud, 2015; Sullivan et al., 2017)

References for Q18:

Raynaud, J., 2015. Carbon Compass: Investor guide to carbon footprinting. London: Kepler Cheuvreux. Available from: http://www.iigcc.org/publications/publication/investor-guide-to-carbon-footprinting

Sullivan, R., Dietz, S., Carlota, G.-M., Matthews, A., Ward, F., 2017. Methodology and Indicators Report. Transition Pathways Initiative, London. Available from: http://www.lse.ac.uk/GranthamInstitute/tpi/wp-content/uploads/2017/01/Methodology.pdf