ClearBridge Investments

Can Energy Stocks and ESG Coexist?

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Energy stocks may not immediately come to mind when contemplating companies that make a positive environmental or social impact. Due to their exploration, production and distribution of greenhouse gas emitting fossil fuels, energy companies are excluded from consideration by many sustainable or socially responsible investment strategies. Environmental, social and governance (ESG) investing, on the other hand, can focus its analysis of energy stocks on positive attributes and progress toward improvement.

ClearBridge takes a conservative approach to evaluating the ESG characteristics of companies in the energy sector and deliberately underweights energy in our ESG portfolios. We acknowledge that oil and natural gas are an important part of our everyday lives - as a transportation fuel source and a relatively clean source of electricity, to name just a few examples. Thus the companies that harvest these fossil fuels do make positive impacts in ways that are not always recognized.

Our energy analysts assign an ESG rating to every company under their coverage based on the ESG considerations most relevant to the overall energy sector and sub-sectors. These considerations focus on environmental management systems, including waste disposal; health & safety; operational history; carbon profiles; water usage & conservation; climate legislation; asset mix; and geographical exposure. Company ESG ratings range from B, which are companies not considered investable in an ESG portfolio, all the way up to AAA for best-in-class businesses.

All energy stocks start with a baseline B rating and can earn a higher rating by (1) driving incremental disclosure of ESG-related data that can be used to establish benchmarks and metrics for future performance and/or (2) incorporating sustainability practices into their business model to the point they are inseparable in driving company performance. Disclosure is especially important in the energy industry because it allows us to track a company's progress and raises the bar for other companies to implement similar practices.

Such criteria lead us to allocate the majority of our energy exposure in ESG portfolios to oil services and technology companies, which tend to help make activities in the energy sector more efficient, with better technology, less environmental impact, and high safety standards.

Schlumberger (ESG: AAA) is an energy services company that provides a wide range of services, including technology, project management, and information solutions to the oil and gas industry, and a good example of the energy companies we target. ClearBridge maintains an ongoing ESG dialogue with the company, whose technological innovations have positively influenced sustainable practices in the oil and gas exploration & production industry. We recently discussed the company's sustainability focus and the tools that quantify their sustainability impact. Schlumberger has established key performance indicators including water usage, greenhouse gas emissions, chemical exposure, land disturbance, traffic and noise impacts that enable it to track progress on issues of greatest concern to stakeholders and the communities where it operates. We also hosted the CEO for a meeting on how the company is integrating its environmental and community impact assessment tools into its business model. With its technology leadership position in energy services, Schlumberger's ESG progress, cataloged in an annual sustainability report, can have a continual industry wide impact.

Pioneer Natural Resources (ESG: A) is one of the largest exploration & production companies in the Permian Basin of Texas. Pioneer has incorporated environmental stewardship into its core set of values and has engendered strong relationships in the Midland, Texas community where it continually must earn its license to operate. The company has taken an innovative approach to the sensitive issue of water conservation by securing a $110 million agreement with city of Midland to use its reclaimed wastewater for field operations. This reduces its reliance on freshwater and will be a competitive advantage as Permian basin development accelerates and water availability becomes a concern. Long term, the agreement reduces Pioneer's overall cost of procuring water and secures supply under a 20 to 28-year contract with the city. The company also adheres to best practices for ground water protection during the completion and operation of its fracking wells.

In addition to equity ownership and direct company engagement, ClearBridge is also involved in broader energy-related initiatives with other investors and stakeholders, such as the Carbon Disclosure Project, Investor Network on Climate Risk and the US Sustainable and Responsible Investment Forum. We believe the integration of industry-specific ESG considerations into our evaluation of the investment case for energy companies as well as proactive engagements focused on greater disclosure and process improvements make the highly selective approach for inclusion of energy stocks consistent with our goals as ESG investors

About the Author

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- 12 years of investment industry experience
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