



## ESG Investment



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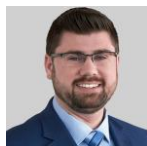
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### Key Takeaways

- ▶ Environmental issues like climate change and the energy transition create large risks and opportunities at the company level and should continue to do so as short-term macroeconomic developments evolve.
- ▶ In an environment of transitory macro crosswinds, ClearBridge believes a stock-specific approach to analyzing environmental, social and governance risks and opportunities remains all the more important.
- ▶ Engaging with the energy sector on emissions reductions is especially important for ClearBridge's net-zero target as part of the Net Zero Asset Managers Initiative.

In an environment of transitory macro crosswinds, ClearBridge believes a stock-specific approach to analyzing environmental, social and governance (ESG) risks and opportunities remains all the more important. In our pursuit of positive outcomes for our clients, we are guided by research-driven stock selection as we seek to generate portfolios distinct from the market and supported by positive ESG characteristics. For example, environmental factors such as climate change remain material issues for investors to consider on a stock-by-stock basis, and the energy transition remains central to our company conversations as our holdings continue to reduce their emissions, often through cost-saving efficiency improvements, and set goals for further reductions.

As a major concern of sustainable investing, climate change and the energy transition represent large opportunities — and risks — at the company level, no matter the macroeconomic and political environment. ClearBridge continues to engage with our holdings to ensure they are building businesses with long-term viability in a lower-carbon economy.

### Engaging with Part-of-the-Solution Companies

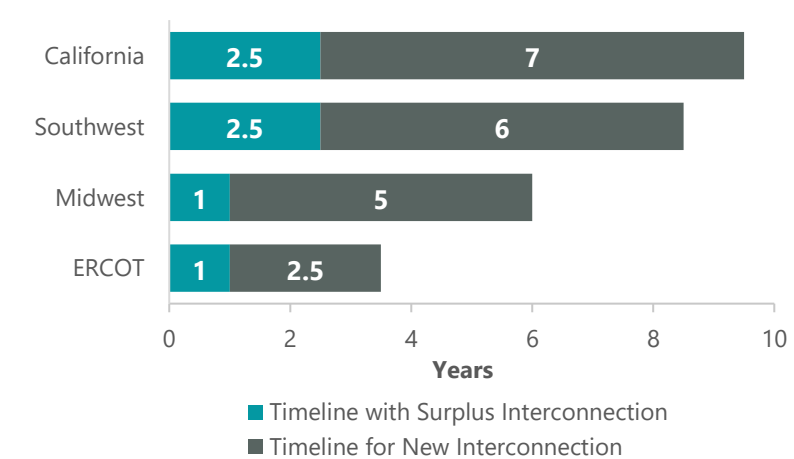
Our fundamental research process includes engaging with companies that are acknowledged leaders in the energy transition, such as ClearBridge holdings NextEra Energy (NEE) and its subsidiary NextEra Energy Partners LP (NEP), two companies accounting for 20% market share of the domestic renewable market. NextEra is still capitalizing on the Inflation Reduction Act through investing in solar and battery power, where it expects stronger growth in the near term, while wind generation additions are expected to see some catching up over the subsequent years.

As we discussed recently in engagements with NextEra’s management team, growth for both entities is underpinned by a bullish power demand outlook, with a 38% increase in demand expected through 2040, driven by decarbonization and electrification.

More recently, the already strong demand for renewables is being amplified by AI and data center expansions, which are expected to double the current 4% of overall power demand currently represented by data centers. The share of AI and data center companies represents 6 GW, but growth in this customer segment will start impacting NextEra’s growth estimates more significantly after 2027. Management has conveyed to us that it will take time to add incremental demand from data centers onto the grid given existent grid constraints (transmission access) are present across all power markets. For example, even in the unregulated Texas power market, where customer growth is faster and generation additions are typically easier, the regulated grid remains a big bottleneck. Adding data center customers to the grid is complicated, as it involves both grid operators and power producers.

In an environment where transmission interconnects (connections between segments of the grid that allow for the transfer of electricity from power generation sources to customers) take years (Exhibit 1), NextEra’s 150 GW of interconnect queue positions become more valuable. Having surplus interconnections reduces renewable projects’ timelines. In the meantime, NextEra’s analytics tools have been helpful in identifying the best data center locations and putting NextEra at a competitive advantage through access to land and transmission.

Exhibit 1: Average Years for Interconnection



ERCOT stands for the Electric Reliability Council of Texas. As of June 2024. Source: NextEra Energy.

We have also discussed the favorable emissions profile at NextEra’s regulated utility, Florida Power & Light (FPL), whose generation mix is dominated by natural gas (73%), along with nuclear (20%) and solar and storage (6%). The utility’s cleaner generation fleet explains its favorable emissions profile, with emissions below the national

average across three main pollutants (20% below the national average for carbon dioxide, 98% below for sulfur dioxide and 71% below for nitrogen oxide). FPL's plan is to expand its solar and storage footprint from the current 5 GW to 30 GW in 2033, with the utility's storage capacity growing from last year's 469 MW to 4.5 GW in 2033 (or 25% compounded annual growth), taking the solar and storage generation share of FPL's generation portfolio from 6% to 38% in 2033.

### **The Energy Transition Supply Chain: Environmental and Social Dimensions**

Electrification, or the move to power more of society with electricity from renewable energy sources, will be reliant upon critical minerals like copper, which we know comes with environmental and social challenges. As part of PRI Advance, a collaborative initiative for investors to address human rights and social issues, ClearBridge has been engaging with holding Freeport-McMoRan (FCX) on these issues since 2022, and the copper producer has been making progress on several areas central to our engagement.

In a recent engagement we continued our discussion on the environmental and physical impact of the company's operations on Indigenous land. The company shared that it has developed an action plan to better understand its adverse impacts at several high-risk sites. On tailings, or mining waste, FCX has adopted the global tailings standard, yet its Grasberg operation in Indonesia remains a controversial asset, in particular due to its impact on water. We asked when we could expect the company's next Water Monitoring Summary report; the company said by end of 2024 was a strong possibility, both for site-level findings and broader tailings for Grasberg. While FCX indicated it was not possible to do so at this time, we shared that we consider providing water monitoring data as a live stream for stakeholders a best practice.

FCX highlighted Grasberg as well as Sierrita, Arizona, as communities it is prioritizing from a social standpoint due to the more complex nature and higher risk profile of those operations. The company stressed how it considers the concept of its social license to be foundational and central to its operations and recognizes it can't be successful without local input and buy-in, for which community engagement is critical. The company seeks to socialize grievances to make sure all stakeholders and communities are aware of the complaint process and it reports on grievance results in quarterly meetings with community partners. We mentioned that other mines commit to address complaints in 30 days and report on the outcome; FCX shared its belief that resolving complaints in a certain time frame is not necessarily indicative of the performance of the grievance system, although it is still looking for a reliable metric for satisfaction of resolutions.

FCX also shared that it engages voluntarily with several Indigenous populations to build trust; unique to FCX, it has a Native American representation team. Several representatives are members of local impacted tribes and report directly to the company's president. This reporting structure has helped to better equip company management with a more in-depth understanding of local cultures and traditions within its Arizona operations. As a result, it will be implementing a Native American Training Program in the near future.

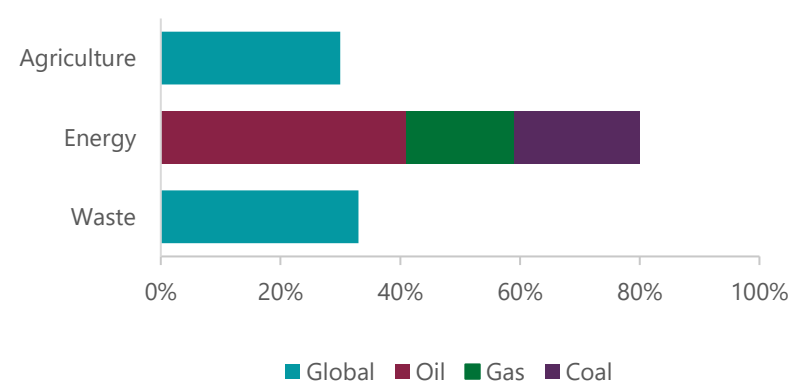
**Opportunities for Change in the Energy Sector**

The energy sector will also be key to the energy transition, which makes engaging with holdings all the more important as there is significant progress they can make to reduce their environmental impact. The sector is one of the more blamed but necessary industries for ClearBridge's net-zero target as part of the Net Zero Asset Managers Initiative (NZAM). ClearBridge remains on track to achieve our NZAM-related goals of having at least 66% of current in-scope assets net zero aligned or subject to engagement, aligning 100% of our assets with the pathway to net zero by 2050 and achieving net-zero emissions across all ClearBridge portfolios by 2050.

As many holdings in the energy sector have similar company-specific dynamics, we take a sector-wide approach to engagement. This enables us to use company-specific information to improve conversations, share best practices and benchmark peers. Central questions include methane and ensuring the cleanest possible natural gas.

We share with companies our view of the importance of methane emissions, which can be considered an easily attained target, but which represent a significant amount of emissions globally. The IEA estimates that production and use of fossil fuels resulted in ~120 million tons of methane emissions in 2023. While agriculture represents the main source of methane emissions, the energy sector has more abatement potential (Exhibit 2), making it a fruitful beneficiary for engagement.

Exhibit 2: Methane Abatement Potential to 2030



As of March 2024. Source: IEA.

Natural gas producer EQT is a leader among ClearBridge energy holdings, and it remains vigilant on its path to achieve net zero on a Scope 1 and 2 basis by the end of 2025, which would make it the first ClearBridge energy holding to do so. In a recent engagement with EQT's CEO and CFO we discussed how the company sees significant value in eliminating pushback on GHG emissions and wants to ensure that U.S. natural gas will be the cleanest answer to the globe's environmental and energy security goals.

While company footprints will differ, we share how a net-zero target such as EQT's is exemplary for other energy holdings and we use it as an informal benchmark in other engagements. We emphasize how EQT spent nearly \$30 million to reduce its emissions, and we share how we believe shareholders and other stakeholders would be supportive of expenditures that are modestly uneconomic in the near term, like EQT's, if those expenditures are able to significantly reduce emissions.

Elsewhere in the space, we have discussed with integrated oil and gas producer ConocoPhillips how it is emphasizing its methane emissions reductions, even using autonomous drones, and eliminating routine flaring. French integrated firm TotalEnergies' methane, down 47% since 2020 nearly in line with its 50% by 2025 goal, is strong and improving, as we learned in recent engagements. Engagements with other producers like Diamondback Energy and Chesapeake Energy also emphasized the installation of continuous monitoring devices to provide real-time visibility into methane emissions performance. This practice not only boosts transparency and disclosure, but it can also support faster response times to potential leaks.

### Leveraging a Long-Term Focus

As sustainability-informed investing moves in and out of the crosshairs of macroeconomic cycles and political debates dominated by shorter-term thinking, ClearBridge remains guided by the long-term fundamental arguments for incorporating ESG factors into the investment process. These ensure we're considering how companies will thrive amid environmental, social and technological changes such as the energy transition. Leveraging our long-term focus and our strong and lasting relationships with company managements, we will continue to use engagement to drive positive change in public equities as part of our investment decision making and active ownership.

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