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Climate Action 100+ Flagged Vote: Southern Company (NASDAQ: SO)

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SUMMARY

The Office of the Illinois State Treasurer intends to withhold its votes from the Board Chair of Southern Company (Thomas Fanning) due to governance shortfalls and limited progress on key performance indicators as detailed in the company's Climate Action 100+ Benchmark Assessment, which have been the subject of repeated requests from investors.

RATIONALE

Lack of an Independent Board Chair

The positions of Board Chair and CEO are combined in a single role at Southern Company. It is the policy of the Office of the Illinois State Treasurer to cast votes against Board Chairs concurrently serving as CEOs or are otherwise non-independent. An independent chairman helps avoid any conflicts of interest in the Board's role of overseeing management.

Greenhouse Gas Emissions Targets

Southern Company's medium-term target to reduce Scope 1 emissions by 50% by 2030 is insufficient.[i] An accelerated target is warranted given that the company is positioned to reach its medium-term target well ahead of 2030 and given the call from the International Energy Agency (IEA) for the elimination of fossil-fuel power generation in OECD countries by 2035.[ii] Peer companies, including Xcel Energy and American Electric Power, maintain 2030 targets of 80%.

Southern Company's emissions targets also exclude Scope 3 emissions, unlike peer companies Duke, Dominion and Xcel.[iii] According to the company's 2020 emissions disclosures, Scope 3 emissions account for approximately a third of total emissions currently disclosed. This does not account for upstream value-chain emissions from the production and transport of fuels like coal and natural gas that Southern Company procures for its power and natural gas businesses, which are not measured and disclosed.

Decarbonization Strategy and Capital Expenditure

Southern Company's decarbonization pathway is incompatible with the IEA's Net Zero by 2050 proposal, which requires net zero emissions from electricity generation by 2035, as well as the Climate Action 100+ Global Sector Strategy expectations.[iv] Southern Company's plans call for 39% of its nameplate capacity in 2050 to be provided by gas, implying that substantial carbon offsets, carbon capture and storage, or other negative emissions technologies – which are not yet ready to be deployed at scale – will be required for Southern to meet its net zero commitment.[v] The company risks overbuilding and stranding generation capacity that may be impossible to keep operating if the company decides or is later forced by regulation to achieve GHG reductions.

Additionally, the Southern has not committed to align capital expenditure with a 1.5° Celsius pathway.[vi] Several of Southern's regulated electric utility peers, including AEP, Berkshire Hathaway Energy, Dominion, and Xcel, have adopted a more ambitious approach to capitalize on the opportunity of lowering emissions within their electricity mix. This includes plans centered on renewables and enabling low-carbon technologies.[vii]

Investors are also concerned with Southern Company's gas business, including the planned capital expenditure of $8.3 billion over 2022 to 2026. Further transparency and reporting on the viability of these plans would better inform investors, including the underlying multi-decade assumptions about customer growth, future policy and cost recovery, and the viability at scale of pipeline-based transition options like renewable natural gas (RNG) and hydrogen.

Lobbying and Climate Policy Engagement

Since 2019, shareholders have requested that Southern Company conduct an evaluation and issue a report that assesses whether the company's direct and indirect lobbying activities align with the goals of the Paris Agreement to limit warming to 1.5 degrees Celsius. Despite repeated requests from investors, the company has yet to produce a climate lobbying report.

Executive Compensation

Investors recognize the company's recent action to integrate its GHG reduction goals and energy initiatives into the CEO's compensation plan. While notable, investors emphasize the Board of Directors can better serve the company and its shareholders by making functional enhancements to the policy:

- Increase the payout target and stretch goals given that the company expects that it will achieve its 50% GHG reduction goal well in advance of 2030.
- Increase the percentage of the long-term incentive award subject to the GHG metric to ensure goal execution, establish balance with potentially contrary incentives, and better align with peers.
- Include downside risk if GHG reduction goals are not met.
- Link the GHG reduction goal to other named executive officers and managers to incentivize meaningful and consistent performance across the enterprise.

Just Transition

As Southern transitions its fleet, it behooves company leaders to establish robust Just Transition plans and provide increased transparency to investors and stakeholders. While investors recognize Southern's commitment to its workers and the communities in which it operates, and investors welcome Southern's readiness to publish a policy outlining its Just Transition principles, investors continue to seek increased and consistent reporting on Just Transition issues, including but not limited to: (1) the assignment of roles and responsibilities at the board and management level; (2) the principles by which Just Transition policies and practices are established; (3) the policies and processes in place for plant retirements, (4) the formal structures by which the company seeks to communicate with and obtain input from workers, worker representatives, community groups, suppliers/contractors, and other stakeholders; and (5) a discussion of potential economic impacts on workers and contractors, as well as the impacts on supply chains, customers, indirect jobs, and local communities.

CITATIONS

[i] The Southern Company, *Implementation and Action toward Net Zero*, 2020, https://www.southerncompany.com/content/dam/southerncompany/pdfs/clean-energy/Net-zero-report.pdf, p. 3

[ii] International Energy Agecncy, *Achieving Net Zero Electricity Sectors in G7 Members*, 2021, https://iea.blob.core.windows.net/assets/9a1c057a-385a-4659-80c5-3ff40f217370/AchievingNetZeroElectricitySectorsinG7Members.pdf, p. 38 and p. 92 calculated from 2019 to 2030

[iii] Duke Energy, "Duke Energy expands clean energy," Press Release, February 2022, https://news.duke-energy.com/releases/duke-energy-expands-clean-energy-action-plan; and Jason Plautz, *Utility Dive*, "Dominion to expand net zero carbon reduction goals to Scope 2 and Scope 3 emissions," February 2022, https://www.utilitydive.com/news/dominion-to-expand-net-zero-carbon-reduction-goals-to-scope-2-and-scope-3-e/618762/; Xcel Energy, "Net Zero Vision for National Gas," 2022, https://www.xcelenergy.com/staticfiles/xe-responsive/Net-Zero-Vision-for-Natural-Gas.pdf

[iv] International Energy Agency, *Net Zero by 2050: A Roadmap for the Global Energy Sector*, 2021, https://iea.blob.core.windows.net/assets/4719e321-6d3d-41a2-bd6b-461ad2f850a8/NetZeroby2050-ARoadmapfortheGlobalEnergySector.pdf at Table 3.2, Key milestones in transforming global electricity generation, p. 117

[v] The Southern Company, *Implementation and Action toward Net Zero*, 2020, https://www.southerncompany.com/content/dam/southerncompany/pdfs/clean-energy/Net-zero-report.pdf, p. 28

[vi] Climate Action 100+, Company Assessment: The Southern Company, accessed on April 1, 2022, https://www.climateaction100.org/company/the-southern-company/#skeletabsPanel3

[vii] Refer to AEP, BHE, Dominion and Xcel recent investor presentations and Dominion's Virginia subsidiary's resource plan.