

Sustainable Gas and Assault at Rio Tinto

Featuring:

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Mike Disabato:

What's up, everyone. And welcome to the weekly edition of ESG Now, where we cover how the environment, our society, and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato, and this week we have two stories for you. The first is on the inclusion of natural gas in the EU's definition of sustainability, basically in its Green Bible. And the second is on a stark report by mining giant Rio Tinto that found widespread sexual assault, racism, and bullying at the company. Thanks as always for joining us, stay tuned.

Mike Disabato:

There's a rush at the moment to build green energy systems, those that can help us stabilize the climate before it completely collapses into chaos. But what is the best way to achieve that stabilization? If I were to ask you which energy systems would be best for that, you'd probably say something like a combination of wind and solar. But what about hydro? Dams are linked to negative impacts on local ecosystems and people, but they emit relatively no carbon. Is that a green energy system or nuclear? Once it's up and running, the only thing you have to worry about is nuclear waste and the possibility of a meltdown, sure. But it produces a massive amount of energy via nuclear fission rather than chemical burning which means it generates electricity without a single output of carbon. What about natural gas? Yes, it's a fossil fuel and methane leaks are a major threat to our climate, but compared to coal, it's clean. It can be put into place quickly in our current system and it can be used when renewable energy is offline, and it's cheap, a major benefit for lower-income countries and individuals.

Mike Disabato:

So, which should you choose? Well, luckily you don't have to, because the EU has created its own Taxonomy of sustainable activities, colloquially called the EU Taxonomy or the EU Green Taxonomy. It could be seen as the Bible of Green and it's been enforced since July 2020. Recently the EU Commission added two controversial verses to the Bible of Green, a verse on nuclear and a natural gas verse. It decided to call both fuel sources, a transitional sustainable fuel, meaning as long as gas and nuclear projects don't replace any low carbon alternatives, they can and should play a major role in the transition to a climate-neutral economy. So today we're going to talk about why the EU added gas to the Taxonomy specifically. And first, we're going to discuss why it's a big deal for investors. And then we're going to discuss why it's a big deal for gas companies. To start us off, I talked with my

colleague, Hanna Ogilvy, who has been creating our methodology for how to deal with the EU Taxonomy. And I asked her to take me through the move by the EU.

Hanna Ogilvy:

Well, I think the question first is, why hasn't gas been included as a sustainable activity until now? So the EU is known to have taken a pretty ambitious approach to defining sustainable activities. So they've set stringent thresholds, performance thresholds for what can be considered aligned with their sustainable framework. And for electricity generation, the EU has said that it will consider renewable sources that produce electricity under 100 grams of carbon dioxide per kilowatt-hour. And that's a lifecycle metric.

Mike Disabato:

A lifecycle metric for measuring carbon basically means you look at the carbon emitted throughout the entire value chain of a commodity, from getting it out of the ground, to shipping it, to burning it. So what the EU did is it looked at the emissions threshold set by the Paris Agreement and consulted with the general scientific community, and then set a threshold of under a 100 grams of carbon dioxide per kilowatt-hour, as a way to tell companies and investors, what is quantitatively considered renewable and sustainable when we're talking energy. The EU also said, not only do you have to meet this threshold, but you cannot have an energy source that could have a long-term negative effect on the environment, due to, for example, the waste it could create. This meant nuclear was out. And when nuclear went out the EU bureaucratic version of all hell broke loose.

Hanna Ogilvy:

So in comes France who's invested quite heavily in nuclear and wasn't happy that nuclear was then excluded from the Taxonomy. So what they did is they approached some of the Eastern European countries who are invested in gas and said, let's develop coalition here. Let's pool what we want included in the Taxonomy together. Let's do research and let's put this forward to the Commission to include in the Taxonomy.

Mike Disabato:

And according to news sources, that's exactly what France did. France thinks nuclear should be part of the energy solution to climate change. It's an idea that has a lot of backing due to nuclear being a low-carbon energy source and that it has a high capacity range, meaning it can operate come rain or shine. But France knew it needed more countries that weren't so tied to nuclear energy to get on board, to change the EU's mind for its Taxonomy. So it got together with Germany and a coalition of Central Eastern European countries and pushed for the inclusion of both nuclear and natural gas, something that Germany and these Eastern European countries really wanted to get included.

Mike Disabato:

Nuclear got in without much substantial change to the Taxonomy. There were some changes there to what is considered an environmental damage, but we aren't going to discuss that today. Because to make this proposal work, the inclusion of gas meant the EU had to make a substantive and controversial increase that a hundred-gram threshold of CO2 emitted per kilowatt-hour that we just talked about because that is too low of an emissions threshold for gas-powered utilities to be considered sustainable.

Hanna Ogilvy:

That threshold would increase to 270 grams of carbon dioxide per kilowatt-hour. And by doing so, they're allowing higher emitting activity to be labeled as green. And this is a really interesting piece because that threshold is based on direct greenhouse gas emissions, and doesn't consider the emissions from extracting or transporting the gas to the power plant and the methane leakages that could result along the way.

Mike Disabato:

Netting out methane from natural gas as emissions is huge for the commodity. The reason the world's natural gas system is so environmentally impactful is because of leaky methane, which locks in far more heat in the short term than carbon dioxide. In fact, it's such a problem that the UN sites methane leaks as one of the major reasons for why we'd likely won't meet the Paris Agreement's goals. And ironically, it's so bad that the EU and the US have been pressing countries to make methane-cutting pledges. So what the EU Commission basically said in this proposal is, forget about all that, we're going to call gas a sustainable transition fuel and so it can be considered green, which pissed off Austria, Denmark, Sweden, the Netherlands, environmental NGOs, as well as some of its own members. One of them said, including gas as a sustainable activity is analogous to treating French fries in the same category as salad. It also meant that other regions were looking at the EU Taxonomy as a standard-bear for what should be considered sustainable in finance and investment and broadly we're now in a weird spot.

Hanna Ogilvy:

There's a lot of fears about what this means for the EU's credibility and sustainable finance. To date the EU has been a real leader in sustainable policymaking and other jurisdictions are following the EU's guidelines to develop their own taxonomies. And in fact, later last year, Russia came out with a green taxonomy, and for electricity generation, they also implemented the same threshold of 100 grams of carbon dioxide per kilowatt-hour threshold. China also excludes fossil gas-fired electricity generation, so the EU's proposal to include gas means the ambition of their green framework may now trail other regions.

Mike Disabato:

The EU tried to appease the angry parties by tempering the decision with a caveat. They will only allow those natural gas-fired plants to be considered sustainable if they are replacing coal-fired powered

plants. So there was a net benefit there because burning natural gas produces about half as much CO₂ as coal to produce the same amount of energy. It also produces far fewer pollutants that can harm human health. But opponents have argued the move stalls the replacement of fossil fuels with renewables, something that the scientific community says needs to happen if we are to stabilize the climate by misallocating investments toward natural gas. They also argue that for investors, the proposal could further dilute what is meant by a green or sustainable fund, because in practice, what this proposal does is it allows a fund that can have fracking companies in it to still be called sustainable or EU Taxonomy aligned.

Hanna Ogilvy:

If the act is passed and so long as gas power generation meets the proposed criteria, EU investors with exposure to natural gas in their portfolios would now demonstrate a larger percentage of taxonomy alignment in their funds. Or in other words, they would demonstrate a larger amount of sustainability in their funds. But to be clear with the inclusion of natural gas in the Taxonomy, the Commission added provisions that gas must be labeled as a transitional activity. So companies disclosing sustainability data in line with the Taxonomy framework will now have to report what amount of their sustainable exposure is from natural gas. And this enhanced transparency means investors can still exclude or divest from natural gas if they don't feel it's a viable long-term environmental solution.

Mike Disabato:

All right, so we've covered the EU fight, the investor implications of that. And now onto the companies themselves, because to get a sustainability label means you'll likely attract the attention of investors and their capital. So would this proposal affect gas utilities in any way? To understand that, I asked my colleague Elchin Mammadov. And here's what he had to say.

Elchin Mammadov:

Yes, it matters a lot, not just to gas utilities, but gas-fired power generators. And there are several different risks for each one of them. For gas-fired power generators, or for utilities that happen to have both renewables and thermal generation, it's important because companies like RWE in Germany, they keep insisting that we're switching off the nuclear, we're going away from coal. Yes, we're building a lot of wind and solar capacity in Germany, however, we need some firm capacity and gas should be that capacity. So companies that even have net-zero targets are thinking about building new gas-fired power plants. They do need to have appropriate legislation in place, et cetera, and support from the government. But it looks like we will see more new gas-fired power plants being built in Europe if this Taxonomy encourages that.

Mike Disabato:

There are a number of German and EU companies that would benefit from this proposal passing through its last remaining political hurdles and a number of Eastern European companies that are

already trying to move away from coal toward relatively cleaner natural gas. And if gas got this sustainability green light, it's not that the natural gas utilities would immediately spring up out of nowhere, but it would grease the machine a bit. And it would also give companies a way to better pitch their projects to sustainability-minded investors since according to Elchin a lot of new natural gas-fired power plants are coming online specifically to shore up renewables of variable capacity. And these companies can say, "Look, we're going to be in line with what the EU Taxonomy says is sustainable. We're going to set phase-out dates for gas, and we're going to implement carbon capture and storage technologies, eventually at some point in the future. This is what the EU Taxonomy requests, and this is what we will be beholden to." And this is all a bit forward-looking though because currently, natural gas utilities are more worried about pricing pressure than they are about a sustainability label.

Elchin Mammadov:

So the hope for gas-fired power plants was that a lot of them are heavily underutilized. So the problem they have now is okay, how can we increase utilization rate? And the hope was that okay, so coal is coming offline, nuclear is coming offline in some countries, so that will open up some room for gas. Yes, there will be renewables, but they will open up the room to increase their gas-fired power generation. Unfortunately, with soaring gas prices in Europe, we haven't seen that happen yet. But the hope is that okay, as gas prices normalize on the global markets in the next year or two, then we may see increased utilization. But for now, in the short term, it's all doom and gloom for gas. Yeah. If anything, we'll see an increase in coal fire power generation, not just in Europe, but across the world. Because again, it's cheaper to burn coal.

Mike Disabato:

There's one more complicating factor with this proposal, by allowing natural gas to be considered a transition fuel, some argue it's giving fossil fuel companies a reason to keep suboptimal or old plants online. Those same plants that would maybe be priced out of the market because those companies can claim the gas utilities are there to be, as the EU asks, to be a backup for intermittent renewables that have these variable energy production times that come and go with the wind and the sun.

Mike Disabato:

So why go through all this? Why spend our episode today talking about a proposal that hasn't yet been affirmed by all the EU member states and the EU Commissions for now? Well, first of all, it's likely going to be passed in some capacity, gas and nuclear as well are likely going to of a certain kind of sustainability label in 2022 and beyond. But the second is, is that this is going to be the task of this year, in my opinion. There are going to be a lot of different discussions as to what should be considered sustainable as the industry tries to define itself in a bit more of a mature way than it has in the past. And we need to be able to watch these things and understand what we are all being sold.

Mike Disabato:

Mining giant Rio Tinto has had a bad go of it in the last couple of years. You may remember the company from their destruction of a 46,000-year-old Aboriginal site to expand its iron ore mine in Australia. And now the company has released a report that itself commissioned that details a culture of systemic bullying, high levels of racism, and the accusation by 21 women that they were raped or sexually assaulted at its mines over the past five years. To discuss this report, I called up our mining expert Sam Block and asked him what he thought about the report that surveyed more than 10,000 Rio Tinto employees.

Sam Block:

The findings of the report were startling, saying there is bullying, sexual harassment, and sexual assault, and racism, that was widespread at this rather prominent international company is certainly upsetting. But also, hearing about these findings is actually maybe a good thing. Companies, especially large ones like Rio Tinto, which has 45,000 people in its workforce, they're going to have a hard time managing something if they don't measure it. So actually commissioning this report probably is a really strong step forward for the company to be able to address the toxic aspects that they have in their culture.

Mike Disabato:

Was this report kind of a broader push by Rio Tinto executives for better self-examination, or was this kind of outside pressure that made them commission this report? What was the reason behind it?

Sam Block:

This report actually came about as part of a broader cultural review at Rio Tinto, that they started following their destruction essentially of these ancient rock shelters in Juukan Gorge in Australia. Transparency around this report was probably a step by the company to come out and say like, "Look, we're addressing this." And I'm sure it's better that they would volunteer this information rather than it somehow leaking out. And then people accusing the company of hiding this from the public. I mean, the company's still recovering from this scandal when they bulldozed these indigenous sites, these rock shelters in Australia. I mean, it led to what you call the dishonorable discharge of the CEO, the chairman, and other executives at the company.

Mike Disabato:

What about just the industry of mining in general, is it just something that you think, this isn't just a problem at Rio Tinto, this is likely a problem in the broader sector that needs to be examined with a bit more urgency.

Sam Block:

It is very likely that this is actually quite common throughout the industry. I mean, mining, it's a pretty macho business. It has been, it probably still is one of the most male-dominated industries. Traditionally and still many places around the world, mining workforces were almost entirely men who lived in these communal dormitories in the middle of nowhere. A lot of workforces are made up of what was called, fly-in fly-out type positions. People are flying in and out with their families. Prostitution is a known issue in a lot of mining camps around the world. But in many ways, the culture at mining companies have been changing a lot over the past decade. I mean, mining companies have been trying to improve living conditions at a lot of their mines. They've been increasing technology and how mining is done, which brings a lot of different types of jobs and they're done within these workforces. And also they have been really trying to increase diversity, especially women in their workforces, I'd say for the past decade or so. But this also creates a need within these mining workforces to protect these underrepresented groups.

Mike Disabato:

I take your point to the industry being an intense place to work, but is this also when you look at Rio Tinto, do they have representation at the top levels for some of these underrepresented groups? What is their general gender diversity on the executive positions?

Sam Block:

Rio Tinto has had a lot of initiatives actually over the years to increase the number of women it has in its workforce. In 2020, about 60% of its graduate hires were women. But this still comes about as only about 19% of its workforce are women overall. Rio Tinto has four out of its nine directors on the board are female, which is about 44%. So, I mean, it's still a minority, but still actually much better than most mining companies. And most companies in general in our MSCI Equity Index, only about 30% of diversified mining companies actually have more than three women on their board. And to put this in perspective, in 2011 the company had two women on its board, and that was 2 out of 16 directors.

Mike Disabato:

Yeah. That's like what, 12 and a half percent. So it seems like even though there is some good representation at the executive level, at the lower levels, at the managerial level, there is a lot of work that needs to be done. So we'll have to monitor how Rio Tinto and the rest of the mining world reacts to this startling report.

Mike Disabato:

And that's it for the week. I want to thank Hanna and Sam for talking to me about the news with an ESG twist. And I want to thank you so much for listening. If you like, what you heard, don't forget to rate and review us, that really helps and it puts us higher on podcast lists when people are looking to listen about ESG. And if you like what you heard, also subscribe. And you can hear this every week, me or Bentley. It's going to be a great time. Thanks as always and talk to you soon.

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