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"We are impressed with the high quality of the GLIO network and the organization's work to promote transparency on ESG disclosure is particularly impactful."

Tom Fanning
Southern
Company

"As companies like ours make significant investments to decarbonize the economy and create a cleaner energy future, GLIO has provided an excellent exposure to international investment capital that is focused on critical infrastructure. GLIO also has developed a valuable platform for examining environmental and emerging issues facing our industry."

Gale Klappa
WEC Energy Group

"Joining the GLIO network of companies has placed PSEG squarely in the global listed infrastructure ecosystem, opened new investor access channels and amplified our strategic messaging."

Dan Cregg
Public Service
Enterprise Group

Mind the gap

By Kevin LIU &
Georgia HALL

In the USA, political spending and corporate lobbying are well-established as legitimate business activities that give companies the means to have their interests heard by politicians and governments. This is particularly true for listed infrastructure companies, whose remuneration frameworks are often underpinned by legislation or determined by regulatory bodies.

At the same time, it is an area that – when not managed appropriately – can expose these companies to heightened business, reputational and legal risks. To minimize these risks, we believe investors should encourage companies to provide greater transparency on their political spending activities and practices and ensure there is accountability and alignment between these and the company's goals and values. Here, we examine this important topic through the lens of the US utility sector.

Political lobbying is increasingly important

US utilities are heavily regulated and, therefore, deeply involved in advocating and lobbying for policies that support their business strategies and day-to-day operations. The adage that "If you are not at the table, you will be on the menu" is particularly relevant for US utilities. While utilities' lobbying expenditures are typically small budget-line items, in aggregate they are a powerful source of influence.

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Any disconnect between statement and action is a risk for investors and an emerging area of stakeholder scrutiny owing to greenwashing concerns.

Despite the importance of political lobbying activities for US-regulated utilities, the topic tends to be a less prioritized and even frequently overlooked aspect of environmental, social and governance (ESG) research into the sector. We believe the tide is starting to change regarding corporate political spending disclosure and policies. In January 2022, for example, the $280bn New York State Common Retirement Fund filed shareholder proposals with eight companies, asking them to disclose their political spending.

In 2021, a record number of climate-related lobbying resolutions were filed at company AGMs.[1] As recent controversies have shown, holding companies accountable and advocating for best practice policy and disclosure are risk management tools that every active listed infrastructure investor should consider.

The adage that "If you are not at the table, you will be on the menu" is particularly relevant for US utilities.

Historically speaking, political lobbying has been given less priority as an ESG topic than areas such as climate change, executive remuneration and diversity and inclusion. This could be explained, in part, by the fact that corporate lobbying is a highly professionalized, embedded and legal[2] feature of corporate America and, as an accepted reality, tends to fly more under the radar. Business ethics and political lobbying are typically included under the 'governance' pillar of ESG, though many forget that this depends on the policy or issue in question.

For instance, US utilities' political lobbying frequently intersects with the 'environmental' pillar in the case of climate change and energy-related policy. In the case of climate change, as discussed further on, we are wary of companies that have a stated commitment to facilitating the energy transition in line with net zero emissions but potentially undertake lobbying activities inconsistent with this position.

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Corporate lobbying has many layers

Corporate lobbying can range from a straightforward approach (narrowly focused on working with congressional allies) to being a far more expansive exercise that involves multiple political branches, coalitions, charitable and non-charitable associations, PR campaigns and other wider tactics.[3]

A useful way of understanding corporate lobbying is to consider the distinction between direct and indirect lobbying.

- Direct lobbying activities are more tangible and easier to monitor, such as the dollars donated to political candidates, parties and organizations. There has been a notable growth in direct lobbying over the past decade following the Supreme Court's 2010 decision on Citizens United, which removed limits on the corporate donations that political groups can accept.
- Indirect lobbying, for instance through trade association memberships and donations to not-for-profit organizations known as 501(c)(4) entities, is a less obvious type of political expenditure. These types of contributions can be much more challenging to trace as companies are often not legally required to disclose them. This makes connecting the dots between a company's political expenditures, lobbying positions and internal policies much more difficult.

A quick scan of some of the donations made to 501(c)(4) organizations by utilities (that do disclose this information) will give little insight into what, and how, the money is being directed. The opaque nature of indirect lobbying increases the risk of poor behavior and is an area where we advocate for greater transparency.

The cost of improper behavior

We believe it is particularly important to monitor the political spending and lobbying practices of US utilities as their remuneration frameworks are highly dependent on legislation and the composition of regulatory commissions. Most utilities also have dedicated teams managing these affairs, making it an intertwined function within their business. Greater dependence on favorable legislation and/or constructive regulatory outcomes has meant investors are highly sensitive toward the risk that these could be reversed.

1 InfluenceMap, 'Climate Policy Engagement Resolutions' (May 2022) https://influencemap.org/report/2021-Climate-Policy-Engagement-Resolutions-18221
2 As per the Lobbying Disclosure Act of 1995.
3 https://academic.oup.com/book/9937/chapter-abstract/157274359?redirectedFrom=fulltext

In addition to monetary fines and business disruption risk from potential senior management changes, improper behavior related to political donations, lobbying practices and campaign contributions can potentially impact how constructive or stringent future regulatory outcomes will be.

There are significant consequences for improper behavior related to political donations, lobbying practices and campaign contributions, as examples over the past few years have shown. In addition to monetary fines – which are a shareholder cost, rather than a customer cost – and business disruption risk from potential senior management changes, these events can potentially impact how constructive or stringent future regulatory outcomes will be. This final point is perhaps the most material because ultimately it is regulation that determines the allowed earnings for these companies, which helps underpin their valuations.

A few notable examples include:

1. In July 2021, FirstEnergy, an Ohio-based regulated electric utility, entered into a deferred prosecution agreement with the US Attorney's Office in relation to its involvement in the Ohio nuclear corruption and bribery scandal.[4] The case involved **$60m** of illegal contributions to public officials – including most notably the former Ohio House Speaker – to secure a billion-dollar, customer-funded bailout package for the company's nuclear units in the form of House Bill 6.[5] Donations were made through a non-profit, dark money, 501(c)(4) group called 'Generation Now'.

   As part of the deferred prosecution agreement, FirstEnergy agreed to pay a **$230m** fine, was charged with conspiracy to commit honest services wire fraud, and agreed to make public disclosures on its website on additional 501(c)(4) contributions. The company also committed to several organizational changes, including: establishing a new board role to support enhanced controls around governance policies and procedures; hiring a new chief legal officer, hiring a new chief ethics and compliance officer and creating a Compliance Oversight Subcommittee.[6]

   During internal reviews related to these investigations, several leadership changes were announced as a result of violations to the company's code of conduct, including termination of the former CEO and SVP of External Affairs.[7]

2. Similarly, in July 2020, Commonwealth Edison Company (ComEd), an Illinois-based electric utility (a subsidiary of Exelon), entered into a deferred prosecution agreement in relation to a years-long bribery scheme. In this case, the company admitted to payments and other private benefits it had provided to related parties of high-level elected officials in Illinois between 2011 and 2019 for the purpose of influencing legislation related to its business.[8]

   Ultimately, ComEd had to pay a **$200m** fine, was charged with a count of bribery, and committed to new governance policies and lobbying practices.

While both these utilities have since >

4 United States Department of Justice, 'FirstEnergy charged federally, agrees to terms of deferred prosecution settlement' (July 2021) www.justice.gov/usao-sdoh/pr/firstenergy-charged-federally-agrees-terms-deferred-prosecution-settlement

5 United States Department of Justice, 'Ohio House Speaker, former chair of Ohio Republican Party, 3 other individuals & 501(c)(4) entity charged in federal public corruption racketeering conspiracy involving $60 million' (July 2020) <https://www.justice.gov/usao-sdoh/pr/ohio-house-speaker-former-chair-ohio-republican-party-3-other-individuals-501c4-entity>.

6 FirstEnergy Corporation, 'FirstEnergy Reaches Agreement to Resolve Department of Justice Investigation' (July 2021) www.firstenergycorp.com/newsroom/news_articles/firstenergy-reaches-agreement-to-resolve-department-of-justice-i.html

7 FirstEnergy Corporation, 'FirstEnergy Announces Leadership Transition' (October 2020) <https://investors.firstenergycorp.com/investor-materials/news-releases/news-details/2020/FirstEnergy-Announces-Leadership-Transition/default.aspx>.

8 United States Department of Justice, 'Commonwealth Edison Agrees to Pay $200 Million to Resolve Federal Criminal Investigation Into Bribery Scheme' (July 2020) www.justice.gov/usao-ndil/pr/commonwealth-edison-agrees-pay-200-million-resolve-federal-criminal-investigation>.

made improvements to corporate lobbying policies, corporate governance safeguards, oversight, and related disclosures, these events highlight the meaningful business, reputational, and legal risks companies face in this area.

The changing regulatory environment

US utilities are regulated by multiple different regulatory bodies. At the state and municipal level, they are regulated by public service commissions, whereas the Federal Energy Regulatory Commission (FERC) regulates utilities involved in the interstate transmission of electricity or natural gas.

State regulators can make their own assessments around the recoverability of trade associations costs, whereas utilities operating under FERC jurisdiction are required to maintain their books in accordance with FERC's Uniform System of Accounts (USofA).[9] Currently, the USofA allows utilities to record separate entries for trade association costs that are operating (above the line) or nonoperating (below the line) in nature, including instructions on when expenses can be considered operating versus non-operating. Expenses paid by utilities that are above the line are generally included in rate recovery.[10]

In essence, the Federal Energy Regulatory Commission wants to better delineate the difference between recoverable expenses and those excluded from rate recovery.

9 FERC, 'Accounting Matters' (March 2021) www.ferc.gov/enforcement-legal/enforcement/accounting-matters>.
10 FERC, 'Docket No. RM22-5-00: Rate Recovery, Reporting, and Accounting Treatment of Industry Association Dues and Certain Civic, Political, and Related Expenses' (December 2021) www.ferc.gov/media/e-2-rm22-5-000.

Figure 1: GLIO Index companies ranked in the CPA-Zicklin Index 2022 – Top 2 tiers from S&P 500 & Russell 1000

Source: 2022 CPA-Zicklin Index*

Category	Companies (Score)
Trendsetter (Scoring 90-100)	ConEdison (100), Ameren (100), CSX (94.3), Dominion (94.3), Norfolk Southern (94.3), Sempra (94.3), Union Pacific (94.3), WEC Energy (94.3), Exelon (92.9), FirstEnergy (92.9), PPL (91.4), Southern Co (91.4), Williams (91.4), Entergy (90.0) & Eversource (90.0)
Tier 1 (Scoring 80-90)	NISource (87.1), PSEG (87.1), Xcel Energy (87.1), AEP (85.7), Pinnacle West (85.7), Alliant Energy (84.3), Duke Energy (84.3), Kinder Morgan (84.3), American Water (82.9), CMS Energy (81.4) & PG&E (80.0)

*www.politicalaccountability.net/wp-content/uploads/2022/10/2022-CPA-Zicklin-Index.pdf

We believe the CPA-Zicklin Index's scoring system and model disclosure for election-related spending best capture what investors and stakeholders should see in companies' disclosure practices and spending and accountability policies for spending with corporate or treasury funds.

The practice of recovering these costs has, understandably, garnered attention in recent years owing to heightened stakeholder scrutiny of political lobbying, and as utility bills have increased off the back of soaring inflation and high gas prices.

FERC recently turned its attention to this issue and is undertaking an inquiry into whether accounting rules should be changed to prevent electric and gas utilities (under its jurisdiction) from recovering certain expenses from their customers while clarifying the meaning of donations for charitable, social or community welfare purposes.[11] In essence, FERC wants to better delineate the difference between recoverable expenses and those excluded from rate recovery.

Many of the utilities we have engaged with in recent years say that they do not pass through their trade association membership fees to customers, which gives us some comfort.

11 Ibid.

Nevertheless, we would like to see greater transparency around how costs are categorized and which ones are passed on to customers. Doing so would help iron out potentially contentious activities that could come under increased stakeholder and regulatory scrutiny if uncovered in the absence of company reporting, such as those that run counter to ratepayers' interests or diverge from a utility's stated commitment to the Paris Agreement.

What we look for

It is not all negative for US utilities. The recently released CPA-Zicklin Index – an annual benchmark that scores US public companies on political spending disclosures and policies – shows that regulated utilities are leading the way relative to other sectors. The Index uses 24 indicators to assess companies' disclosure practices and spending and accountability policies for corporate or treasury funds, using companies' publicly available reporting. The Index does not judge a company's political spending or address the alignment

The governance pillar is the bedrock of all ESG and sustainability progress, and, as past controversies have shown, a utility's environmental and social attributes can become irrelevant when things go wrong.

of outlays with the company's core values or policies. Instead, it looks at how the company governs and manages its election-related spending. Nevertheless, once the dollar figures are known, investment managers and stakeholders can use the information to assess alignment with a company's stance.

It is no surprise to see a strong uptick in utilities' disclosures and policies and therefore a strong score for the sector in recent years. Despite this, however, we believe ongoing engagement to ensure accountability and transparency is of paramount importance. We also remain wary of a small handful of regulated utilities that lag their peer group, especially when it comes to directing funds to 501(c)(4) entities without the appropriate disclosure.

We believe the Index's scoring system and model disclosure for election-related spending best capture what investors and stakeholders should see in companies' disclosure practices and spending and accountability policies for spending with corporate or treasury funds. Figure 1. highlights the 'Trendsetter' and 'Tier 1' constituents of the GLIO Index. US Utilities are heavily represented in the list, but there are a handful of listed infrastructure companies and US utilities that still lag their peers. For these companies to receive a higher score, certain improvements in disclosure and policies would be needed.

"The Index findings show how companies, including utilities, have embraced political disclosure and accountability policies. These practices have become the norm, with companies that have no or weak policies viewed as outliers," said Bruce Freed, president of the Center for Political Accountability, which undertakes the Index research in conjunction with The Wharton School's Zicklin Center for Governance & Business Ethics.

Freed added that the Index provides

the foundation for the next step that companies need to take through the CPA-Zicklin Model Code of Conduct for Corporate Political Spending. "The Model Code gives companies a framework for approaching and governing their election-related spending," he said. "This goes beyond disclosure and accountability to include a company's wider obligations and responsibilities and the broader impact of its election-related spending. These are very important as the level of risk companies face has grown exponentially."

In the unique case of utilities' ability to pass on certain lobbying costs to customers and their critical role in facilitating the energy transition, we would also argue that the sector needs to go one step further and also detail:

- The level of alignment between a stated climate change position and lobbying activities.
- How lobbying expenditures are treated and who they are borne by.

The climate change and greenwashing challenge

Political lobbying is a real risk for utilities if it is not aligned with their public commitments. Our concern is that utilities might be actively marketing themselves by talking about climate change, but simultaneously undoing this through direct and indirect lobbying activities in a manner akin to greenwashing. For this reason, we are cautious about companies that have a stated commitment to facilitating the energy transition in line with net zero emissions but undertake lobbying activities that are inconsistent with this position.

There is also the issue that by funding politicians to advance short-term objectives, such as a growth in rate base and capex spending plans, utilities >

may support individuals who oppose their longer-term goals or whose actions undermine democratic systems. Good corporate governance requires management and company boards to take the longest possible view on policy matters and ensure that any positions taken are aligned to the company's stated strategy and commitments.

Climate-related lobbying is an increasing focus for the investment community with the launch of a Global Standard on Climate-related Lobbying in 2022. We are seeing more and more shareholder resolutions on climate change-related lobbying. In 2021, investors filed a record number of annual meeting resolutions that called on companies and their industry associations to align their policies with the goals of the Paris Agreement.[12]

12 InfluenceMap, 'Climate Policy Engagement Resolutions' (May 2022) <https://influencemap.org/report/2021-Climate-Policy-Engagement-Resolutions-18221>.

In 2021, for instance, we supported a shareholder resolution calling on Sempra Energy to provide a "Report on Corporate Climate Lobbying Aligned with Paris Agreement". When deciding how to vote, we considered how one of Sempra Energy's subsidiaries, SoCalGas, lobbied against energy efficiency codes and standards between 2014 and 2017 and was subsequently fined for passing these costs on to customers.[13]

While the resolution did not pass, it received a meaningful level of support at 38%. In response, the company committed to producing a report on the climate change positions of its trade association memberships.

13 State of California Public Utilities Commission, 'Order Instituting Rulemaking Concerning Energy Efficiency Rolling Portfolios, Policies, Programs, Evaluation, and Related Issues (Decision Different of Commissioner Rechtschaffen)' (09 February 2022) <https://docs.cpuc.ca.gov/PublishedDocs/Efile/G000/M449/K785/449785834.PDF> pp. 2-22.

Conclusion

To our minds, investors must pay attention to political lobbying disclosures and policies when researching environmental and social factors, especially in light of the E, S and G linkages. The governance pillar is the bedrock of all ESG and sustainability progress, and, as past controversies have shown, a utility's environmental and social attributes can become irrelevant when things go wrong.

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