

ACCR Investor Briefing

Electric Power Development Co., Ltd. (J-POWER)

(TYO: 9513)



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About ACCR

The [Australasian Centre for Corporate Responsibility](#) is a philanthropically-funded NGO that monitors environmental, social and governance (ESG) practices and performance of listed companies. We undertake research and highlight emerging areas of business risk through private and public engagement, including the filing of shareholder proposals.

Background

J-POWER is Japan's largest coal power operator, reporting 64.88 million tonnes of CO₂ emissions in FY2020 (equating to 5.6% of Japan's total emissions). The company's long-term corporate value will depend upon successful decarbonisation in line with Japan's legislated target to reach net zero GHG emissions by 2050.

ACCR and a US\$3 trillion investor group including Man Group, HSBC Asset Management and Amundi have filed three shareholder proposals for consideration at J-POWER's ordinary general meeting of shareholders to be held on 28 June 2022.

ACCR and the investor group have been engaging privately with J-POWER on its decarbonisation commitments and strategy since January 2022. Individual members of the investor group have also been engaging with the company before then. The company response to the concerns raised during engagement has been inadequate.

This briefing addresses matters in relation to the proposal and presents a summary of the investor group's concerns and case for support. Detailed company analysis can be found in the [report by Transition Zero](#), published 11 May.

Proposals put forward by the shareholder group

Owing to local legal requirements, the shareholder group has presented a package of three proposals, each framed as a partial amendment to the company's Articles of Incorporation. Each proposal stands alone legally, but we believe the package is in the interests of shareholders. Each proposal, as well as the formal reasoning given to the company, is set out below:

Proposal 1

Partial amendment to the Articles of Incorporation

(1) Details of the proposal

The following clause shall be added to the Articles of Incorporation:

1. To promote the long-term value of the Company, given the risks and opportunities associated with climate change, and in accordance with the Company's commitment to achieve net-zero GHG emissions by 2050, the Company shall set and disclose a business plan with science-based short-term and mid-term GHG emissions reduction targets aligned with Articles 2.1(a) and 4.1 of the Paris Agreement.
2. The Company shall report, in its annual reporting, on its progress against such business plan on an annual basis.

(2) Reason for the proposal

Long term institutional investors in the Company see its corporate value depending upon a credible decarbonisation strategy and science-based short-, medium- and long-term GHG emissions reduction targets aligned with the goals of the Paris Agreement and investor expectations.

While we welcome the Company's intention to achieve carbon neutrality by 2050, the Company's targets are not yet aligned with the goals of the Paris Agreement. This presents a range of material financial risks to shareholders. We consider that setting science-based targets, and disclosing a business plan to achieve them, would best manage these risks and protect corporate value.

Proposal 2

Partial amendment to the Articles of Incorporation

(1) Details of the proposal

The following clause shall be added to the Articles of Incorporation:

The Company shall disclose, in its annual reporting, details of how it assesses the alignment of capital expenditure plans with the Company's GHG emissions reduction targets.

(2) Reason for the proposal

Long term institutional investors in the Company see its corporate value depending upon a credible decarbonisation strategy and science-based short-, medium- and long-term GHG emissions reduction targets aligned with the goals of the Paris Agreement and investor expectations.

Capital expenditure aligned with such targets is of particular significance for the Company's corporate value given the high emissions from its coal-fired power generation business, and the low level of economic and feasibility certainty attaching to technologies detailed in the Company's Blue Mission 2050. We consider that corporate value would be better protected with greater disclosure of

how the Company assesses the alignment of its capital expenditure with GHG emissions reduction targets.

Proposal 3

Partial amendment to the Articles of Incorporation

(1) Details of the proposal

The following clause shall be added to the Articles of Incorporation:

The Company shall disclose, in its annual reporting, details of how the Company's remuneration policies will incentivise progress against the Company's GHG emissions reduction targets.

(2) Reason for the proposal

Long term institutional investors in the Company see its corporate value depending upon a credible decarbonisation strategy and science-based short-, medium- and long-term GHG emissions reduction targets aligned with the goals of the Paris Agreement and investor expectations.

We consider that a direct linkage between remuneration and achievement of GHG emissions reduction targets to be in the Company's interests, as an important mechanism to incentivise executive performance against decarbonisation goals and protect corporate value.

The attraction of these proposals is that they are high-level and non-prescriptive, yet designed to direct the company's focus to material areas of improvement, where shareholders can monitor and measure successful implementation. The proposals are carefully drafted to avoid an inappropriate level of shareholder involvement in the detail of company strategy development. Instead, the principles-based approach provided guidance but leaves discretion about the detail to the judgement of the company's board and management.

The language is embedded within clear and widely accepted institutional investor expectations such as the Climate Action 100+ Net-Zero Company Benchmark, Climate Action 100+ Global Sector Strategies: Investor Interventions to Accelerate Net Zero Electric Utilities and AIGCC Investor Expectations of Asian Electric Utilities Companies.¹

The reference to "science-based" is consistent with Article 4.1 of the Paris Agreement² and calls upon the company to adopt a science-based method to set GHG reduction targets in line with investor expectations.

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<https://www.climateaction100.org/wp-content/uploads/2021/10/Climate-Action-100-v1.1-Benchmark-Indicators-Oct21.pdf>

<https://www.climateaction100.org/wp-content/uploads/2021/10/Global-Sector-Strategy-Electric-Utilities-IIGCC-Oct-21.pdf>

<https://www.aigcc.net/wp-content/uploads/2020/11/Asia-Utilities-IE-final.pdf>

² Article 4.1 of the Paris Agreement refers to emissions reductions "in accordance with best available science".

ACCR and the co-filing group believe that these proposals are in the best interests of shareholders and present a strong case for support.

PROPOSAL 1 – TARGET-SETTING

Case for support

J-POWER has announced short-, medium- and long-term targets for reducing CO₂ emissions from its domestic electric power business including reducing such emissions to net zero by 2050. We welcome J-POWER's commitments but the targets remain seriously insufficient and the current decarbonisation strategy does not set out a credible path to meet them.

There is a clear rationale for this proposal for the following reasons:

1. J-POWER's current short- and medium-term emissions reduction targets are not aligned with the goals of the Paris Agreement.
2. J-POWER's short-, medium- and long-term emissions reduction targets do not apply to its overseas business.
3. J-POWER's current decarbonisation strategy lacks detail and relies upon high-cost coal-based technologies unproven at scale and facing significant financial risks and technical uncertainties.
4. J-POWER's plans place an over-reliance on unabated coal into the future, inconsistent with the goals of the Paris Agreement.
5. The co-filing group see J-POWER's long-term corporate value depending upon a credible Paris-aligned decarbonisation strategy and emissions reduction targets. Their absence presents a range of material financial risks to shareholders.

ACCR and the co-filing investors consider that setting science-based targets and disclosing a business plan to achieve them would best protect corporate value.

J-POWER's emissions reduction targets

In February 2021, J-POWER announced a medium-term target of reducing CO₂ emissions from its domestic electric power business by 40% by 2030 (compared to average results from FY2017 to FY2019) and a long-term target of reducing such emissions to net zero by 2050. It recently announced a short-term target of reducing CO₂ emissions by 7 million tonnes by 2025 (compared to average results from FY2017 to FY2019).

Its medium- and long-term GHG reduction targets are limited to its domestic electric power business and do not extend to the company's significant overseas business.

The company's short and medium-term target falls short of what is required by the goals of the Paris Agreement. Science-based sectoral decarbonisation pathways as adopted in investor expectations are clear that in advanced economies such as Japan electric utilities need to achieve a majority (i.e. >50%) of decarbonisation by 2030 from a 2019 level.

J-POWER's decarbonisation strategy

J-POWER's decarbonisation strategy is set out in its Blue Mission 2050 and medium-term business plan.³ It relies heavily upon burning coal alongside imported fossil fuel-derived ammonia, coal gasification and carbon capture, utilisation and storage (CCUS). There is no concrete plan to retire old coal assets.

Independent economic analysis, including from TransitionZero and Wood Mackenzie, has highlighted the financial risks of over-reliance upon such technologies in the electric utilities sector.

In a company engagement profile⁴, TransitionZero conclude that J-POWER is not on track to meet its current 2030 emissions reduction target given the reliance upon such technologies. Its report highlights that to meet this target, all of the company's coal plants would have to see ammonia co-firing above 40% by 2030, which is not yet technically established and would come at significant cost. In an earlier report on ammonia co-firing, coal gasification and CCUS in February 2022⁵, TransitionZero found that such technologies are high-cost with limited carbon-reduction potential in the electricity sector.

In considering CCS, Wood Mackenzie also found that by 2040, renewables and storage have lower LCOE compared to other options. ⁶ "CCS options remain more expensive than renewables and thus will only fulfil the role of providing dependable capacity." (p 26) AIGCC points to additional significant technical challenges including scalability, suitability and transport alongside difficulties financing commercially.

Renewable energy plans

J-POWER's Medium Term Management Plan dated 30 April 2021 includes a target of developing renewable energy of 1,500 MW or more compared to FY2017 by FY2025.

In October 2021, the Japanese government issued an updated Basic Energy Plan nearly doubling its earlier renewables target to 36-38% of power supplies in 2030. Major Japanese companies have also intensified calls for more renewable energy in Japan to meet commitments through initiatives such as RE100 and respond to pressure to green global supply chains.

We encourage J-POWER to set out a clearer path for increased renewable energy investment to capture these opportunities and reduce transition risk to its business.

³ The short-term 7 MtCO₂ reduction target by 2025 was published on 11 May 2022 in J-POWER's Progress of J-POWER Medium-Term Management Plan.

https://www.jpowers.co.jp/english/news_release/pdf/news220511_1e.pdf?rss=enews

⁴

<https://www.transitionzero.org/company-engagement-profile-j-powers>

⁵ <https://www.transitionzero.org/reports/advanced-coal-in-japan>

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https://www.aigcc.net/wp-content/uploads/2021/12/AIGCC-CCS-Report_final.pdf

Transition / stranded asset risk to J-POWER and shareholders

J-POWER's current decarbonisation strategy and targets expose it to material financial risk including the risk that continued investment in coal-based power generation technologies will end up stranded as Japan and the company's overseas markets decarbonise and renewable energy and storage continue to decline in cost.

This proposal seeks to encourage J-POWER to strengthen its current decarbonisation strategy and targets to protect and enhance its long-term corporate value.

PROPOSAL 2 – CAPEX ALIGNMENT

Case for support

J-POWER's capital expenditure plans anticipate significant future investment in its coal power generation business and in speculative "advanced coal" technologies.

There is a clear rationale for shareholders to support this proposal as per the following reasons:

1. J-POWER has not committed to align future capital expenditure with its long-term emissions reduction target and does not disclose the methodology it uses to assess the alignment of its future capital expenditure with its decarbonisation goals.
2. Capital allocation is of particular significance for J-POWER's corporate value given the high emissions from its coal-fired power generation business and independent, credible concerns regarding the technical and economic feasibility of the decarbonisation technologies in which J-POWER proposes to invest and their emissions reduction potential.
3. Corporate value would be protected with enhanced disclosure of how J-POWER assesses the alignment of its capital expenditure with its emissions reduction targets.

Stranded asset risk of current capital expenditure plans

As noted above, J-POWER's current decarbonisation strategy relies heavily upon burning coal alongside imported fossil fuel-derived ammonia, coal gasification and CCUS. There is no concrete plan to retire old coal assets. It currently plans to invest, for example, in adding a coal gasification unit to the 41-year-old Matsushima coal-fired power plant (the GENESIS Matsushima project).⁷

Independent economic analysis including from TransitionZero and Wood Mackenzie has highlighted the financial risks of over-reliance upon technologies including ammonia co-firing, coal gasification and CCUS in the electric utilities sector.

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https://www.jpowers.co.jp/english/news_release/pdf/news210416_2e.pdf

The company's current capital expenditure disclosure does not provide investors sufficient information to assess its plans or their carbon reduction potential. It does not, for example, plan to publish a feasibility strategy setting out its CCUS strategy.

This proposal seeks additional capital expenditure disclosure to help protect and enhance the company's long-term corporate value. It does not affect Board discretion and business judgement regarding capital expenditure but simply disclosure of how (if at all) the company assesses the alignment of such expenditure with its decarbonisation goals.

PROPOSAL 3 – REMUNERATION ALIGNMENT

Case for support

This proposal adopts the language in the IIGCC Global Sector Strategies: Investor Interventions to Accelerate Net Zero Electric Utilities.

It does not require executive remuneration linked to J-POWER's emissions reduction targets but rather disclosure of how (if at all) its remuneration policies will incentivise progress against its targets. It preserves management discretion.

There is inadequate disclosure of the link between executive remuneration and J-POWER's GHG emissions reduction targets.

We consider, in line with institutional investor expectations, that the link between executive remuneration and J-POWER's GHG emissions reduction targets should be disclosed, with who it applies to, share of the pay linked to the target and the impact of under/over performance explicitly stated.

To increase the chances of success, and protect corporate value, short- and medium-term compensation incentives should be clearly aligned to the strategic objective of transitioning to net zero.

To preserve management discretion, however, the proposal only calls for disclosure of how (if at all) J-POWER's remuneration policies will incentivise progress against its GHG emissions reduction targets.

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