Vistra Corporation

USA, Electric Utilities

Accounting		Climate Assumptions		Audit		Date of analysis: April 23 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2020 Report date: February 26 2021 AGM: April 28 2021
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Some concerns	Climate Action 100+ company, so seen by investors as key to driving global net zero emissions.

Summary view:

- As an integrated electric power generation business with wholesale activities and retail sales of electricity and gas, the company has significant exposure to transition and physical risks associated with climate change. Its stated goal for reduced emissions by 2030 and objective of carbon neutrality by 2050 appear to be absent from its 10-K report.
- Steps taken to transition away from coal-based generation are embedded in financial impairments once plans are actioned, but it is not apparent that wider aspects of climate change are contemplated in accounting judgements or the audit. Additional separate disclosure of costs, investments, and commitments would help investors monitor progress.

Background

The Business.

- Vistra is an integrated retail and electric power generation business. Its activities include electricity generation, wholesale energy sales and purchases, and retail sales of electricity and natural gas, predominantly in the US. In 2017 it emerged from the bankruptcy of Energy Future Holdings and has since made several acquisitions, including a merger with Dynegy.
- In Q3 2020, Vistra updated its reportable segments to: Retail; East, West and Texas (regional generation segments); Sunset (operating plants with announced retirement plans); and Asset Closure (closed plants and mines undergoing decommissioning and reclamation).
- Vistra has 52 generation facilities. By primary fuel (and % of capacity) these include: 36 natural gas (64%), 10 coal (29%), 3 oil (0.7%), 1 nuclear (6%), and 2 renewables (0.5%).
- A further 9 coal/lignite facilities are included in the asset closure segment; the range of reasons cited for retirement plans include efforts to reduce the company's carbon footprint.
- It also has 12 lignite coal mines in Texas and two waste-to-energy surface facilities in PA.
- Given the focus on fossil fuel-fired electricity generation, Scope 1 emissions are by far the greatest category at 105.5 metric tons CO_2e in 2019 (Scope 2 .25mt., Scope 3 not addressed).

Approach to climate change.

- The company's Climate Report (published September 2020) sets out a goal to achieve a 60% reduction in CO_2 equivalent emissions by 2030 (versus a 2010 baseline), and an objective to achieve net-zero carbon emissions by 2050. These goals are absent from the 10-K.
- In the last five years, Vistra has transitioned its generation portfolio from largely coal-fueled to predominately natural gas-fueled, and invested in solar and battery energy storage.
- Vistra considers that nearly 65% of its output is generated from 'low-to-no-CO_2-emitting natural gas, nuclear, and renewable assets'. This approach s reflected in its 10-year plan, with natural gas maintaining prominence, and coal generation being replaced by renewables.
- Vistra views climate change as providing greater opportunities than risks. Its long-term strategy aims to capitalise on anticipated demand from electrification of the economy. It views natural gas as critical during the buildout of renewables and battery storage.
- The company is required to purchase environmental allowances in order to operate its facilities in northeastern states under the Regional Greenhouse Gas Initiative. Net purchases were $339m in 2020. It expects increasing costs to be largely offset by increased revenue.
- Vistra identifies a wide range of regulatory and legislative risks associated with its operations and closures, including current and potential new federal or state requirements. Risks are also identified relative to changes in technology, increased conservation efforts and focus on sustainability, and efforts including subsidies for renewable generation that may impact the wholesale market. These may reduce the value of existing facilities, leading to early asset

retirements and/or added costs to adapt to new technologies and low-carbon alternatives. Completing renewable development projects is also subject to uncertainties.

- Vistra indicates that the potential physical effects of climate change, such as increased frequency and severity of storms, floods, and other climatic events, could disrupt its operations and lead to significant costs. This is demonstrated by winter storm Uri in February 2021, which resulted in surging demand for power, gas supply shortages, operational challenges such as handling frozen fuel, and a significant load-shed event (rolling blackouts). The 10-K indicates that costs, estimated at $0.9bn to $1.3bn, were still being calculated.
- Vistra also describes financing risks, as investors focus on ESG and climate change. The company states that to date, policies to cease investing in (or divest from) holdings of companies with operations in fossil fuels represents a small fraction of its equity investors, but that this could grow. Institutional lenders too are becoming attentive to sustainability.
- A new ESG Index is given a 10% weighting in the 2021 Executive Annual Incentive award.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- There is one direct reference to climate change in the notes to the US GAAP financials. This is in relation to contingencies, specifically the Biden administration's Executive order of a review of various agency actions taken under the prior administration.
- Goodwill of $2.6bn is almost entirely allocated to the retail sector, and retail trade names (also not amortised) represent a further $1.4bn. Amortised intangibles are $1bn, including customer relationships having a remaining life of three years. There were no impairments.
- Property plant and equipment of $13.5bn includes $12.4bn of power generation assets and structures, land, and office and other equipment. Remaining useful lives are disclosed as ranging between 1 and 33 years. While there is no apparent disclosure of total useful lives by category, we estimate average lives as 11 years, and average remaining lives as 8.6 years[1].
- Impairment charges were $356m in 2020, relating to three coal facilities in the Sunset segment. Amounts related to PP&E were $305m, inventory $19m, and $32m for a capacity contract related to one of the facilities. Charges were driven by the significant decrease in facility asset lives given the plans announced in 2020. There is no indication that impairment testing contemplated wider effects of climate change.
- The asset retirement obligations (AROs) liability is based on anticipated requirements. Several more stringent rules are pending or could be introduced in the future. ARO liabilities for nuclear decommissioning are recovered through the regulatory process, with assets being held in trust. Obligations of $748m at the end of 2020 are for land reclamation related to lignite mining, remediation or closure of coal ash basins, and generation plant disposal costs. This excludes costs where the period of remediation remains indeterminable.

Consistency with other reporting		Significant concerns

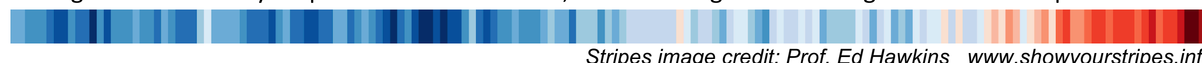
- With there being extensive commitments to close facilities, reclamation/remediation activities, and development projects in renewables, additional separate disclosure of associated costs, investments, and commitments within the financials would help investors monitor progress of specific initiatives. Regarding climate commitments made by the company, it is concerning that these appear to be absent altogether from the 10-K.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.

[1] In the absence of better data, implied lives are roughly estimated using depreciation expense and, for average lives - start of year productive asset values, for remaining lives – ending values net of depreciation.



- However, the Climate Report refers to scenario analysis undertaken in 2020. Vistra engaged a third-party to conduct analysis of physical and transition risks over the next 10-30 years, for the purpose of informing its strategy and allocation of maintenance capital. The scenarios used climate projections adopted by the Intergovernmental Panel on Climate Change (IPCC) for: (i) Sustainable Future Scenario, (ii) 2°C Scenario, and (iii) Current Policies Scenario (business as usual).

Paris alignment		Significant concerns

- With no visibility, there can be no alignment with the goals of the Paris Agreement.

Audit: visibility in CAMs and consistency check

Audit firm: Deloitte & Touche LLP	Responsible partner: Thomas James Kilkenny
Audit standards: PCAOB (USA)	

Visibility in Critical Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- CAMs include: Tax Receivable Agreement Obligation, Fair Value Measurements - Level 3 Derivative Assets and Liabilities, and Impairment of Long-Lived Assets. The first and last of these requires estimates of future cash flows (over 40 years for the tax item, indefinitely for intangibles that are not amortised, and over remaining lives for assets assigned finite lives).
- No mention is made of climate specialists. On impairment, the auditor indicates the assistance of 'energy commodity fair value specialists' was used to develop estimates of forward natural gas and electricity prices, and to assess the reasonableness of forward capacity prices.

Consistency check		Some concerns

- PCAOB audit standards require the auditor to read other information that is presented together with financial statements and the auditor's report thereon. The auditor's report is silent on the outcome of the review, which implies that no material inconsistency was identified in the other information within the 2020 10-K.
- The 10-K appears to be internally consistent, given very minimal discussion of climate change outside the financial statements, and close to none within the financials.

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.		**Key**
		Good practice
		Few concerns
		Some concerns
		Significant concerns

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