Investment Stewardship Group

BlackRock

Voting Bulletin: ČEZ, a. s.

As part of our fiduciary duty, BlackRock's Investment Stewardship team (BIS) advocates for sound corporate governance and business practices that are aligned with long-term sustainable financial performance. This objective underpins all our engagements and votes at company meetings.

We engage company leadership on key topics emphasizing governance practices including management of environmental and social factors that potentially have material economic, operational or reputational ramifications for the company.

We determine our engagement priorities based on our observation of market developments and emerging governance themes, and evolve them year over year as necessary. The BIS team's key engagement priorities include:

1. Board quality
2. Environmental risks and opportunities
3. Corporate strategy and capital allocation
4. Compensation that promotes long-termism
5. Human capital management

Our approach to investment stewardship is grounded in an expectation that the board will oversee and advise management, influencing management's approach to key business issues. When effective corporate governance is lacking, we believe that voting against the responsible director(s) is often the most impactful action a shareholder can take.

We are committed to enhancing the transparency of our stewardship practices. Where we believe it will help to understand our voting decisions at shareholder meetings, we will publish a Voting Bulletin explaining the rationale for how we have voted on select resolutions, and (where relevant) provide information around our engagement with the issuer.

Company	**ČEZ, a. s.**
Market	Czech Republic
Meeting Date	29th June 2020
Key Resolutions[1]	**Item 10:** Approve Remuneration Policy **Item 12:** Recall and Elect Supervisory Board Members **Item 13:** Recall and Elect Members of Audit Committee **Item 14:** Shareholder proposal - Amend Business Strategy
Board Recommendation	**Item 10:** FOR **Item 12:** FOR **Item 13:** FOR

[1] Full meeting agenda and resolutions can be accessed at: https://www.cez.cz/en/investors/general-meetings/annual-general-meeting-2020-85465

	Item 14: NONE
BlackRock Vote	BIS voted AGAINST recalling and electing Supervisory Board Members for the company's lack of progress on climate-related reporting and insufficient information with regards to the identity of the directors. For similar transparency issues, BIS voted AGAINST the remuneration policy, and recalling and electing the Members of the Audit Committee. BIS voted AGAINST the shareholder proposal to amend the business strategy due to its overly prescriptive nature and the lack of sufficient rationales for the restrictions on capital allocation decisions that it would introduce.

Overview

BIS believes that as companies face material climate risks, they must demonstrate that management have assessed how climate may impact operations and have determined an appropriate business strategy. As we describe in our commentaries on our Approach to Engagement on Climate Risk and Emissions, Engagement, and Transition to a Low-Carbon Economy, we expect robust disclosures of climate-related risks and opportunities in line with the recommendations of the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD). Greater transparency will contribute to improved market-level data, better engagements with shareholders, and more informed voting decisions aligned with long-term value creation.

In our engagements with companies on managing climate-related risks and opportunities and adapting to the energy transition, we are mindful of both the need for an acceleration of the market's approach to disclosure, and the challenges inherent to that task. We recognize that producing comprehensive disclosures requires a significant investment in resources and time on the part of a company. We also recognize that each company is unique, starting from its own baseline, with its own capacities and limitations. We seek to achieve a balance between recognizing a company's current position, while encouraging the appropriate urgency in advancing reporting and the practices underlying it.

Climate Risk

ČEZ, a. s. (CEZ) is a Czech power company controlled by the Czech Republic Government (70%). The Company's core businesses are generation and distribution of electricity, electricity trading, generation and distribution of heat, gas trading, and relate activities.

As a fiduciary on behalf of our clients, BIS has engaged with CEZ over the past several years on a range of governance and material sustainability topics, including climate-related disclosures.

CEZ has reduced CO2 emissions by 20% since 2016 due to electricity generation from cleaner energy sources. The company has also set a target to generate carbon neutral electricity no later than 2050 (scope 1 & 2), consistent with the European Union's climate ambitions. In 2019, about 55% of the electricity generated by CEZ originated from nuclear power and other zero-emission sources. In order to reduce its carbon emissions, CEZ has announced plans to progressively phase out its coal-fired power plants, starting with the least efficient. Specifically, CEZ plans to decrease its current coal-fired capacity by half from 7.8 GW in 2016 to 3.9 GW by 2025 and decrease further to 2.5 GW in 2035 and ultimately to zero by 2050. In 2019, coal-fired power plants represented 45% of CEZ's capacity.[2]

[2] See https://www.cez.cz/webpublic/file/edee/ospol/fileexport/investors/investment-stories/20_06investorpresentation.pdf

CEZ discusses climate related challenges in a dedicated section in its 2019 annual report[3] but its disclosures lack some of the key features we would expect, including TCFD-aligned reporting to further describe the resilience of the company's business model under different energy transition scenarios, the responsibility of the Supervisory board with regards to climate-related issues, and further details on short and medium term greenhouse gas (GHG) emissions reduction targets. Although CEZ has disclosed to investors that it expects the carbon intensity of its power generation to be reduced to 0.27tCO2/MWh in 2035, it remains above average in Europe (for reference, CEZ's carbon intensity was 0.36 t CO2/MWh in 2019).[4] The current reporting provides some insights about the company's operational carbon emissions and management's perspectives on the challenges of the EU climate goals, but is not aligned with the TCFD framework. Hence, these disclosures fall short of our expectations.

The company's inadequate public disclosure is increasingly putting it at odds with its global peers regarding long-term climate adaption strategies and raises concerns about how CEZ is managing climate risk and the transition to a lower-carbon economy. We expect greater action on target-setting and a justification for company's approach relative to its peers.

This is in line with our view that the risks of climate change and the transition to a lower carbon economy present material regulatory, reputational, and legal risks to companies. As a fiduciary for our clients, we believe it is necessary to understand that these risks are being adequately disclosed and overseen.

We are encouraged by the fact that the carbon intensity of the company's business model has fallen and should continue to improve given the current strategy. Moreover, the company's current strategy focuses on decarbonization, phasing out coal-fired generating facilities, ensuring stable supplies when those facilities are shut down, and continuing the preparation of new nuclear power projects. We are encouraged by the company committing to decommission old and low profit coal units[5] and indicating its willingness to consider new medium-term carbon targets derived from its 2050 carbon neutrality ambition, as well as to further review the alignment of its disclosures with the TCFD framework.

However, the company's limited progress in explicitly aligning its reporting with the TCFD recommendations and lack of public commitments to move towards TCFD-aligned reporting falls short of our expectations of large carbon emitters with a previous history of engagement with BIS on this topic.

Rationale for BlackRock Vote

Item 10: Approve Remuneration Policy (AGAINST)

The policy contains insufficient detail concerning incentives and performance-related elements such as how performance measures are defined or weighted. Moreover, CEZ only provides limited disclosure on award levels for both its short-term and long-term incentive plans.

We acknowledge that CEZ is presenting its remuneration policy for the first time to a shareholder vote, and we understand that reporting practices on those issues are not yet well established in the Czech Republic. However, we consider the current level of transparency to be insufficient for us to understand the remuneration plans and support the approval of the remuneration policy.

Item 12 & 13: Recall and Elect Supervisory Board Members and Members of the Audit Committee (AGAINST)

---

[3] See https://www.cez.cz/webpublic/file/edee/ospol/fileexport/investori/vz-2019/annual-report-2019-cez-group.pdf

[4] According to the European Energy Agency, the CO2 emission intensity of electricity generation was <300gCO2/kWh in 2016 and on a decreasing trend: https://www.eea.europa.eu/data-and-maps/daviz/co2-emission-intensity-5#tab-googlechartid_chart_11

[5] See https://www.cez.cz/webpublic/file/edee/ospol/fileexport/investors/investment-stories/20_06investorpresentation.pdf

At the time of our analysis, the names of the candidates were not disclosed, which makes it impossible for minority shareholders to make an informed decision about the election of board members.

CEZ is not an official TCFD supporter and has made no public commitment regarding the alignment of its disclosures with the recommendations of the TCFD. Despite a section in the company's 2019 annual report dedicated to climate protection, these climate-related disclosures do not demonstrate sufficient progress towards CEZ aligning its reporting with the TCFD recommendations.

In line with our approach of holding directors accountable when a company is not effectively addressing a material issue, we voted against recalling and re-electing Supervisory Board members for lack of progress in relation to climate-risk reporting. More generally and consistent with previous years, the lack of information on the identity of the Supervisory Board members to be (re)elected ahead of the AGM is a key impediment to us supporting items 12 and 13.

Item 14: Shareholder proposal – Amend Business Strategy (AGAINST)

A group of shareholders tabled a resolution to amend the business policy of the company.[6] In accordance with the Articles of Association, the business policy is defined by the framework of business activities to be pursued by CEZ.

In particular, the proponents asked that the following sections be amended:

- CEZ's Group Mission and Vision;
- Key Areas for Fulfilling Main Strategic Priorities;
- Effective operation, optimal use and development of power generation portfolio;
- Business Concept and Strategic Priorities of CEZ Group.

The portion of the resolution that relates to decarbonizing CEZ's generation portfolio addresses a material risk and is in line with our views on the need for companies to properly manage and oversee these risks to ensure a smoother transition to a low-carbon economy. Accordingly, we expressed our concerns about how the company has been addressing climate related issues via our vote against item 12.

However, we do not believe that such a prescriptive modification of CEZ's business policy by shareholders would be a suitable mechanism to address these issues. It could have unclear and far reaching consequences for both the company and its shareholders. We considered that by directly addressing the corporate strategy and priorities of the company, this proposal strays into micromanagement and we are generally not supportive of proposals that are overly prescriptive in nature.

Moreover, the proposed amendments would significantly restrict the nature and amount of some capital allocation decisions including the ones made on the basis of a contractual agreement with the Czech Republic Government such as the creation of new nuclear power units. The proponents have not provided compelling rationales as to why these restrictions are warranted and how they would be practical and beneficial for the company and its shareholders. For these reasons, we voted against the shareholder proposal.

BIS voted in favour of all other management proposals.

We will continue to engage with the company on its governance practices and reporting. Absent progress on public disclosures across the above-mentioned sustainability and governance issues, we will continue to signal our concerns by voting against relevant board members who are responsible for such oversight.

[6] See : https://www.cez.cz/webpublic/file/edee/ospol/fileexport-s/pro-investory/investor-relations/vh2020_slm1/aj/vh2020_doplneni-poradu-en.pdf