Client Alert

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First Telco Green Bonds Set Path for Connectivity Industry

Sustainability frameworks mark first activity from the telco sector, building off research on the industry's effects on greenhouse gas emissions.

Key Points:

- Issuances by Verizon and Telefónica and a published framework from Vodafone indicate market acceptance of common themes unique to the telecommunications sector.
- These developments show how similar energy-intensive industries can benefit from sustainable finance.

Telecommunications companies have long been among the most active participants in the capital markets but, until recently, they have not participated in sustainability-themed finance, such as green bonds. That changed when Telefónica issued the sector's first green bond in January 2019, building off of a Sustainable Development Goal (SDG) bond framework published in late 2018. Verizon quickly followed suit with its own green bond issuance in February 2019. Vodafone may well be next, having published a framework in 2018. Sustainability frameworks explain how the bond or loan connects to the company's business or investment activities (e.g., building a wind farm) and how those activities connect to sustainability outcomes (e.g., less greenhouse gas emissions), as well as certain procedural aspects of the offering.

Despite their distinct features, these frameworks overlapped in key ways in terms of how they connected telecommunications investment and spending to reduced greenhouse gas emissions. The market's acceptance of these frameworks suggests that the recent series of offerings has established helpful guideposts for the next wave of issuers.

The Telco Energy Efficiency Story

At first glance, telcos may not seem to be an obvious candidate to participate in sustainable finance. Connectivity providers that supply the infrastructure behind television, the internet, telephones, and wireless communication use a great deal of energy. Analysts estimate that they account for 2% of total energy consumption in the United States.

But certain research, including by Carbon Trust (a not-for-dividend consulting company) and the Global e-Sustainability Initiative (GeSI) (an information and communication technology industry group), argues that connectivity technology is closely related to decreased greenhouse gas emissions. For example, this technology enables less extensive physical travel, which is greenhouse gas intensive. Although

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telecommuting and related technology systems increase electricity usage, Carbon Trust and GeSI estimate that for every kiloton of greenhouse gas emissions caused by this additional electricity usage, five kilotons are avoided.

Relying on similar reasoning, Telefónica, Verizon, and Vodafone all feature in their sustainability frameworks that proceeds will be allocated towards investments to improve their connectivity performance, including the rollout of 5G and other technologies that will allow for improved performance. This improved performance is meant to create energy efficiency savings across industries, enabling smart grids, enhanced machine-to-machine communication, and better performance of public transportation, among other advancements. Carbon Trust and GeSI estimate that deployment of these technologies (assuming sufficiently powerful connectivity) could triple the greenhouse gas savings achieved by current technology, which they say already accounts for 1.5% of total global greenhouse gas emissions.

Another part of the energy efficiency story featured in each of the frameworks published by Telefónica, Verizon, and Vodafone is that proceeds will be allocated towards investments to improve existing infrastructure, directly enhancing energy efficiency. Such improvements include more efficient cooling facilities and, in Telefónica's case, swapping copper wire for fiber-optic.

Non-CapEx as Eligible Projects

These frameworks also demonstrated how, under the right circumstances, expenditures not qualifying as capital investments can constitute projects eligible for allocation of proceeds from sustainable financings. For energy-intensive industries like telecommunications, this includes expenditures under power purchase agreements from renewable energy providers and, in Verizon's case, leases on green buildings.

Telefónica and Verizon included in their frameworks allocating bond proceeds to purchase power under power purchase agreements with renewable power providers. In Verizon's case, this provision included purchases pursuant to "virtual" power purchase agreements that do not involve physical delivery by the renewable power producer. Sustainability frameworks commonly include investments in renewable energy production capacity, and each of the three companies included that component in their frameworks. Including the purchase of renewable power supplied by others is less common, but not unprecedented. Sustainalytics, which issued second-party opinions for each of the three frameworks, explained that this element of the frameworks supported the overall development of the renewable energy market, and indirectly supported the financing of renewable power.

Verizon included in its framework allocation of the proceeds towards payments under leases, on a capitalized basis, of new or existing buildings with certain energy-efficiency certifications. Again, sustainability frameworks often include investments in green buildings or in improvements to energy efficiency in real property. Including finance lease payments is the more interesting aspect of Verizon's framework. Sustainalytics explained this element as "supporting the overall development of the green buildings markets, which delivers indirect environmental benefits" and indirectly enabling construction of green buildings.

Learning From the Telco Green Bonds

The success of the recent telco green bond issuances suggests that the market would be receptive to further sustainable financings by telco companies using similar eligible project categories. More broadly, the success of the recent telco green bond issuances suggests an increased sophistication among

investors in appreciating the indirect effects of an industry. Such a development would potentially have wide ranging consequences given the unique sustainability considerations in each industry.

If you have questions about this *Client Alert*, please contact the author listed below or the Latham lawyer with whom you normally consult:

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