Case study

ENGIE Chile – tapping multilateral finance to support a just transition

August 2024

The International Finance Corporation (IFC) has provided innovative financing to support ENGIE Chile's ambitious energy transition, reinforcing the company's social policies and processes to help ensure its transition is just and socially responsible.

Summary

- ENGIE Chile is embarking upon an aggressive decarbonisation programme, in close cooperation with its workers and policymakers.
- The company is committed to phasing out 1.5 GW of coal by 2025, through disconnecting 0.8 GW and decommissioning or converting 0.7 MW to run on natural gas or other fuels, and to developing 2 GW of supply from renewables.
- Facing challenging market conditions, in 2022 ENGIE Chile approached IFC to support its transition with an innovative green and sustainability-linked loan, with coupon payments linked to decommissioning coal plants, building out renewables and promoting more women within the business.
- Although the transaction was not explicitly linked to just transition outcomes, it has helped enhance ENGIE Chile's social policies and stakeholder engagement. The company has a just transition strategy based on three pillars: employment and training, local development and environmental management.
- The transaction will support both the company's decarbonisation and clean energy employment opportunities for its workers.
- For the wider sustainable finance market, linking such transactions to just transition outcomes will be a crucial next step, although identifying metrics to measure success will be challenging.

Just Transition Finance Lab case study series

The Just Transition Finance Lab case study series profiles emerging practice in bringing the just transition to life, examining the interplay between companies, finance institutions, workers, communities and policymakers. A major focus is on the role that finance can play in supporting meaningful action.

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The Just Transition Finance Lab is based at the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science.

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Introduction

ENGIE Chile has mapped out an aggressive transition away from coal towards renewables, energy storage and natural gas. The utility has worked closely with unions and communities to support affected workers and their families. In a challenging financing environment, it approached the International Finance Corporation and other investors for a green and sustainability-linked loan to support its transition, enhancing social protections for its workers along the way.

Tocopilla thermal complex

The company

ENGIE Energía Chile is a diversified energy company, listed in Santiago and 60%-owned by France-based multinational utility company ENGIE. It traces its roots back to Electroandina, set up in 1915 to supply power to copper mines in northern Chile. The company is now the fourth largest power generating company in the country, with 2.6 GW of capacity; the third largest transmission operator, with more than 3,000 km of transmission lines; and it operates more than 1,000 km of gas pipelines.

The investors

Part of the World Bank Group, IFC is the world's largest global development institution focused on the private sector in developing countries. Its mission is to support private sector entities to deliver green growth, inclusive jobs and impactful projects. It places a high premium on the social and environmental assessments it undertakes as part of its investment process, and its Performance Standards are widely used across the financial sector to identify and manage sustainability risks and impacts.

The term 'just transition' is not currently included in any IFC policies, although its sister institution, the public sector-focused International Bank for Reconstruction and Development (IBRD), runs a Just Transition for All initiative, focused on people and communities affected by coal phase-outs around the world.[1] IFC's climate advisory services provide support to companies on developing just transition plans to manage social risks and identify opportunities for the energy transition.

In addition, IFC's Performance Standards, which are part of IFC's Sustainability Framework, address issues central to the just transition. "The topics that are covered in the just transition framework are embedded or included in Our Performance Standards", says Pablo Taborga, principal environmental specialist at IFC.

The standards provide IFC's clients with guidance to help them manage environmental and social risks and impacts. They include the management of labour-related issues, establishment of community and worker grievance management mechanisms, and stakeholder engagement processes.

ILX Management also participated in the financing, as a 'B lender'. ILX is an Amsterdam-based investment manager, which runs the ILX Fund, an emerging markets-focused private credit fund, on behalf of leading European pension funds. The US$1 billion fund invests in private sector loans arranged by multilateral development banks, and seeks to generate measurable impact in terms of delivering the objectives of the UN Sustainable Development Goals, along with attractive risk-adjusted returns.

The policy context

Historically, Chile's power grid has relied heavily on coal-fired generation. In 2019, coal supplied around one-third of the country's power, with hydro and natural gas accounting for much of the rest, at about 27% and 19%, respectively. Although growing rapidly from a very low base, wind and solar supplied just 13.3%.[2] In 2019, the government and generation companies committed to eliminating coal from Chile's power mix by 2040, with a first phase to remove 31% of coal-fired capacity, totalling 1.7 GW, by 2024.

To do so, it drew up a plan through a "participatory process and decentralized citizen dialogue" with "public sector, civil society, academic world, NGOs, environmental groups, neighbourhood committees, workers' unions, companies, international organizations and representatives from communities and indigenous peoples".[3]

1. *Just transition for all: the World Bank Group's support to countries transitioning away from coal*, World Bank, n.d.
2. *Energy Statistics Data Browser*, International Energy Agency, 2023
3. *Plan of Phase-Out and/or Reconversion of Coal Units,* Ministerio de Energía, Government of Chile, 2020

The plan incorporates just transition principles. As then-Minister of Energy Juan Carlos Jobet wrote in its introduction, "It should be noted that to protect the opportunities of the most vulnerable communities, we have initiated a Just Transition plan. This transition seeks to ensure the addition of an equitable social and environmental development, promoting mobility and creating quality jobs that improve not only the economic and environmental conditions of the territories, but also the standard of living of people."

The government established a roundtable in 2018 to consider the economic, social, security and environmental implications of its coal phase-out. It found that, under an energy transition scenario, 2–8,000 more jobs would be created by 2030, and 13–20,000 more by 2050 compared with business-as-usual. However, it also heard that 4,000 direct and 9,000 indirect jobs would be lost from closing coal-fired plants. "While representing a minor impact from the macroeconomic point of view, [this] is significant for communities and workers of the areas involved", the plan noted.

In response, the plan called for "commune or regional development programs to generate new sources of employment", along with "dialogue between those affected and the decision makers... a clear schedule of cessation of activities, linked to an alternative development strategy [and] employment-focused measures, including: training and retraining of workers, early retirement and employment insurance, support programs for new entrepreneurs, and a focus on the green sectors of the economy (renewable energies, energy efficiency, recycling, etc.) for the generation of new jobs".

In the resulting agreement with industry, leading utilities pledged to take 1 GW of coal-fired capacity offline by 2024. By 2021, however, AES Gener, Enel and ENGIE had announced more ambitious plans: to retire 2.3 GW of coal plants by 2025.[4]

Decarbonisation at ENGIE

Within this wider effort, ENGIE Chile's decarbonisation plan is aggressive. In 2018, coal made up 58% of its 1.9 GW of installed power generating capacity, with natural gas accounting for 33%, diesel 8%, and just 1% coming from renewables. In a plan unveiled in 2021, the company committed to phase out 1.5 GW of coal by 2025, through disconnecting 0.8 GW and decommissioning or converting 0.7 MW to run on natural gas or other fuels, and to develop 2 GW of renewables. This will, the company says, take place within the context of a just transition.

Pablo Villarino, chief of communications, stakeholders and corporate affairs at the company, says the process of developing a just transition strategy began in January 2018, in discussion with unions and government bodies. "The company has taken a proactive approach to the just transition", Villarino says. "It has been several years of work, involving top management, the unions, local government and central government, as well as ensuring we are aligned with the rest of the industry and the other coal exit processes that are happening."

Daniel Moreno, a trade union representative of the company participating in the Ministry of Energy's just transition roundtable, agrees that ENGIE Chile has worked collaboratively to address the impacts of the transition. There has been a "real commitment between the company and union to carry out this process in the best possible way and with the least negative impact on the workers", he says.

This work was undertaken in parallel with a similar effort at the parent company. ENGIE Group began working on a just transition plan in 2021, resulting in the publication of its Just Transition policy in July 2022.[5] This work at the group level provided confirmation that ENGIE Chile's achievements were "exemplary", says Villarino.

> "There has been a real commitment between the company and union to carry out this process in the best possible way, with the least negative impact on the workers.
>
> *Daniel Moreno, trade union representative, ENGIE Chile*

4. *Chile speeds up plans to close coal plants, to retire half its fleet by 2025*, S&P Global, 2021
5. *Just transition policy*, ENGIE Group, 2022

ENGIE Chile's just transition strategy is based on three pillars:

- **Employment and training**: to foster employment opportunities, develop skills, seek the retention of talent, and support the relocation of employees affected by the transition where necessary.
- **Local development**: to create economic value with direct benefits for affected communities, focusing on rebuilding drivers of development.
- **Environmental management**: to ensure a decarbonisation process with no net negative impacts to the environment.

ENGIE Chile's coal phase-out began in 2018, when it announced its commitment to decommission its first two coal-fired plants, in Tocopilla, in the north of the country, by 2019. In parallel with the closure of these plants, it is developing renewable energy and storage solutions nearby, and is converting some of the existing assets.

The development of these new renewable assets – some of which are being built within a two-hour drive of Tocopilla – has enabled some reassignment of staff, says Villarino. Of the 191 people employed at ENGIE's Tocopilla complex, half stayed working at the U16 combined-cycle gas turbine in Tocopilla. Of the rest, approximately one-third were reassigned to the gas-fired power plant in Mejillones and around 30 people took voluntary early retirement, leaving the company "with full compensation", he adds, while the remainder found employment outside the company.

> We provided a strong countercyclical role by providing financing at a delicate moment for the company.
>
> *Anaïs Gardien, investment officer, IFC*

By 2022, however, wider market conditions were proving challenging. The company had already borrowed significantly to fund its capital expenditure related to its transition, and it was buffeted by high spot power prices in Chile. Its high debt-to-earnings ratio meant that it was coming under pressure from credit rating agencies, which were threatening to downgrade the company unless it strengthened its balance sheet.

In response, ENGIE Chile decided to approach IFC to secure financing and re-leverage new and existing renewable energy and storage assets to support its decarbonisation programme.

"We provided a strong countercyclical role by providing financing at a delicate moment for the company", says Anaïs Gardien, an investment officer at IFC. "We wanted to show the market we would support the company in its decarbonisation programme in a context of growing uncertainty in the Chilean power sector."

The transaction

In June 2023, IFC announced the closing of a US$400 million green and sustainability-linked loan (SLL) to ENGIE Chile. It includes US$200 million from IFC; US$114.5 million from institutional investors under IFC's Managed Co-lending Portfolio Program (through which IFC syndicates loans to its network of institutional investors); US$35 million from ILX Fund as a B Lender; and US$50 million in a parallel loan from DEG, the international development arm of German state bank KfW. (See Box 1 for an explanation of SLLs.)

The loan has a tenor of 10 years, longer than the five to seven years that is currently typical for the corporate loan market in Chile, says Gardien, and this enables the company to improve its debt profile. ENGIE used the loan to re-leverage two solar energy projects in northern Chile, with a combined capacity of 268 MW, and to finance battery energy storage systems linked to those projects.

By combining financing from a development finance institution with private sector capital, IFC was able to leverage its balance sheet and help de-risk the investment for private sector investors.

As a green and sustainability-linked loan, the interest payments are tied to ENGIE Chile meeting three predetermined key performance indicators (KPIs). The first is that, by the end of 2026, the company will have closed or converted its remaining 1 GW of coal-fired power plants. The second KPI requires it to have added at least 500 MW of renewables capacity by the same date.

Tocopilla thermal complex

Box 1. Sustainability-linked loans (SLLs) explained

Sustainability-linked loans, such as that extended by IFC to ENGIE Chile, are relatively new financing tools, first offered by banks in 2017. The interest rate paid by the borrower is linked to one or more environmental, governance or social key performance indicators (KPIs). If the borrower meets the targeted improvement in the KPI, then it pays a lower interest rate. If it misses the target, the rate is (usually) increased.

These loans are designed to improve sustainability outcomes and have proved popular with banks and borrowers alike. Issuance grew rapidly, to €954 billion in 2022, according to data from Spanish bank BBVA.[6] This is greater than the US$899 billion of green, social, sustainability and sustainability-linked bonds issued in that year.[7]

However, the market has come under fire for some parties agreeing to unambitious KPIs or to KPIs that do not address borrowers' most material sustainability issues. Issuance dropped to €731 billion in 2023, as banks imposed tighter standards and more rigorous target-setting deterred some borrowers.

Guidance exists that aims to ensure SLLs are robust. Leading loan market bodies have produced the Sustainability-Linked Loan Principles, voluntary guidelines that offer a framework for selecting KPIs and targets within SLLs, and provide advice on reporting and verification.[8]

6 *Second-party opinion: Government of Chile sustainability-linked bond framework*, Sustainalytics, 2022
7. *Green & sustainability-linked loan newsletter,* BBVA, February 2024
8. *Sustainable bonds insight 2023 published*, Environmental Finance, 20 February 2023

By adding those first two KPIs, IFC was "able to make sure that the loan takes into account the company's whole transition story", says Gardien. "It's not just financing renewable energy assets and batteries – it's also specifically addressing coal decommissioning by a certain date." The 2026 deadline is earlier than ENGIE Chile's original plan and the Chilean government's 2040 deadline, she notes.

In its final KPI, ENGIE Chile committed to increase the proportion of women in its management from 24% in 2022 to 31% by the end of 2026. "This will be the most challenging one to meet", says Rosaline Corinthien, chief executive at ENGIE Chile, because of the limited pool of female talent from which to hire. She notes Chile's power sector is growing, increasing competition for both male and female staff, while cultural attitudes to parenting continue to place most responsibility on women, making it difficult for mothers to progress their careers.

If the company meets these three KPIs by 2026 and continues to show compliance over the life of the loan, the interest rate it pays on the loan will be reduced. Eduardo Milligan, chief financial officer at the firm, describes this as a "small step down".

The KPIs in the SLL are similar to those adopted by the Chilean government in its own sustainability-linked bond (SLB) programme. In March 2022, it issued a US$2 billion SLB, the first from a sovereign issuer.

"

IFC thought that our baseline was very good, and they commended us on that several times.

Alison Saffery, corporate finance and investor relations manager, ENGIE Chile

The interest payments on the bond are linked to Chile meeting a carbon emissions reduction target by 2030, and achieving 50% of power generation from renewables by 2028 and 60% by 2032.[9] In 2023, the government added another KPI, for 40% of board members of large companies to be women by 2031.

As with any IFC transaction, the ENGIE Chile loan was conditional on the borrower implementing an environmental and social action plan (ESAP). A number of ESAP elements touch on just transition-related issues, says IFC's Taborga. He cites a revised grievance mechanism for workers and communities, aligned with the IFC Performance Standards and the need to develop stakeholder engagement plans.

"We had very good grievance mechanisms in place", says Alison Saffery, ENGIE Chile's corporate finance and investor relations manager, "but there were still areas where we could improve on them." Specifically, the ESAP requires that ENGIE Chile improves the accessibility of its grievance mechanisms to ensure that stakeholders who might not have access to the internet have alternative methods to raise issues. It also requires avenues to issue anonymous complaints, records to assess trends and KPIs, measurement of the company's response time, and different mechanisms to enable adequate closure of grievances.

In total, Saffery says, the IFC ESAP required ENGIE Chile to undertake 13 actions, including some that needed to be completed ahead of a 30 November 2023 deadline for the disbursement of the second US$200 million tranche of financing. "There are a number of elements relating to the just transition and working with communities", she says. "That said, IFC thought that our baseline was very good, and they commended us on that several times."

The environmental and social due diligence process also involved visits to communities close to the company's existing projects. For example, says Saffery, part of the group that inspected ENGIE's Calama wind farm visited local indigenous communities to see projects funded by the company.

The structure of the SLL is set out in an SLL framework document. Saffery says the company plans to make this document publicly available, but that, for the time being, it needs to be kept confidential, as it contains plans around plant decommissioning that may yet be subject to change. "We don't want to make that public... until we have a message that is consistent", she says.

9. *Sustainability-Linked Loan Principles (SLLP)*, LSTA, 2023

Next steps for a just transition

While the SLL will provide financing for ENGIE Chile to 'transition in' to cleaner energy sources, it will also incentivise the company to 'transition out' of the next tranche of its coal-fired power plants. These include the five coal units in Mejillones, with a combined capacity of more than 1 GW, which are to be decommissioned by 2025. As in Tocopilla, the process will be undertaken according to the characteristics of the commune and in dialogue with affected stakeholders. The company has since announced a US$70 million investment to convert one of these units to natural gas, and it has won a contract for a synchronous condenser at the site, which is a motor used to help stabilise the grid.

Any workers based in Mejillones who face redundancy between now and 2026 will either be relocated within the company or entitled to voluntary early retirement or training opportunities, says Gabriel Marcuz, the managing director of the company's flexible generation business, who is in charge of the decarbonisation transformation programme. So far, 25 people have already been relocated.

The company's experience with its Tocopilla site will, Moreno hopes, lead to a broader approach to retraining. "There is a lot of experience from the first process that took place in Tocopilla, and it is very important to be able to work with this experience in mind", he says. He notes that a lot of training has been provided to help workers find new employment within the energy sector, but some workers are looking for skills applicable to different industries.

Energy companies have, however, come under fire for not addressing those workers indirectly affected by plant closures. The Workers' United Center of Chile says that these workers have been overlooked in Chile's transition away from coal and claims that, for every 50 workers in a coal plant, there are 150 subcontracted workers and 450 indirect jobs.[10]

ENGIE counters that the conversion of its assets "will continue to support the development and [the] local workforce of these cities in the future, which is a fundamental part of our Just Transition strategy".

Dismantling process of the boilers at the Tocopilla thermal complex

Tocopilla thermal complex

The steam turbine at the Tocopilla thermal complex, which ceased operations in 2022

10. *Chile's whirlwind energy transition leaves workers stranded*, RTL Today, 1 February 2024

The demonstration effect

IFC's sustainability-linked loan is not designed to address those elements of ENGIE Chile's transition. However, Taborga notes that, by requiring enhancements of ENGIE Chile's corporate environmental and social policies, management systems and procedures, IFC's financing will cascade improvements throughout the company, including around just transition-related elements. "The beauty of working with ENGIE Chile is that it has very sophisticated environmental and social policies and frameworks.Through the implementation of the actions required in the ESAP, the company will gradually be aligning its operations to IFC Performance Standards as well, and by adding IFC standards to their systems and frameworks… the process we are working on will percolate to all the elements of the company's just transition", he says.

Gardien adds that the financing demonstrated to the market the institution's wider support for the clean energy transition and coal decommissioning.

Guillaume Le Bris, head of infrastructure and energy at ILX, notes that, while being implicit to the transaction and embedded in ENGIE's policy, the just transition is not an explicit feature of the deal, which rather supports transition to a decarbonised energy mix and aims for an impact on gender balance.

> "By adding IFC standards to their systems and frameworks, the process will percolate to all elements of the company's just transition".
>
> *Pablo Taborga, principal environmental specialist, IFC*

Gardien confirmed that the transaction was not intended to directly support a just transition, and that any KPIs linked to a sustainability-linked financing tool need to be objective, quantifiable and measurable. Some just transition-related metrics could qualify, such as the number of jobs created in renewable energy, or number of households supplied by clean energy – and those can already be incorporated within KPIs in regular SLL loans. Further, Gardien adds that investors and lenders would need to see a baseline. "It's not enough to have a KPI: [the borrower] needs to demonstrate the ambitiousness of the proposed level compared to the historical baseline and benchmark it."

An additional challenge is communicating with investors on relatively complex and ill-defined concepts such as the just transition.

IEM plant within the Mejillones thermal complex

"The just transition is not yet an approach that has been embedded in the minds of all investors", Le Bris notes. "Just transition is a complicated concept on which we enter into a dialogue with investors." He adds that a first step to engaging institutional investors with issues around the just transition lies in getting their views on providing energy transition finance. "Some institutional investors have not yet incorporated policies on transition finance", he says.

Le Bris believes that greater discussion of just transition issues could help institutional investors in their internal dialogue and policy setting around supporting carbon-intensive companies in transitioning out of fossil fuels.

The process has also generated important lessons for managing relations with workers and their unions, says Moreno. For trade unions at other companies, he suggests that "it is very important to be aware of the process and take ownership of it, then discuss it with the workers openly until they are convinced. Then propose a work plan with the company if it hasn't done so, and talk, talk, talk until both parties find the best solution for the workers."

For company management, he stresses "it is essential to have open channels with the workers, to inform them about the progress of the process without hiding anything, and provide them with peace of mind. Workers need to realise the good intentions of the company."

Lessons learned: observations from Nick Robins, Executive Director of the Just Transition Finance Lab

ENGIE Chile's approach to a just transition is clearly underpinned by a strong domestic policy context in Chile and a supportive parent company that is taking just transition issues seriously. IFC's provision of financing to support ENGIE Chile's decarbonisation programme came at a crucial time for the utility, and has enabled it to move forward with, and indeed accelerate, its ambitious energy transition agenda. In applying its Performance Standards, IFC was able to help ENGIE Chile improve its already advanced environmental and social risk and impact processes and policies, helping to ensure that its transition from coal towards renewables is as just and fair as possible.

Photo: Chris Watt Photography

The sustainability-linked loan is not, however, explicitly linked to a just transition at the Chilean company, and therefore it does not represent a 'just transition' SLL. Therefore, the question remains: what might it take for financiers to use sustainability-linked finance, whether loans or bonds, in direct support of a just transition?

Critical to such financings are KPIs that are material to the issuer's sustainability challenges and that provide stretching targets against a baseline that demonstrate improved performance. Without credible KPIs and ambitious targets, issuers and investors both risk accusations of 'greenwashing'.

Identifying such KPIs for just transition sustainability-linked financings (SLFs) may be challenging. A recent IFC paper on finding robust social KPIs for such transactions, which noted the lack of just transition indicators used in SLFs, observed that "just transition is a highly contextual process", making it challenging to find universally applicable KPIs.[11] But it suggested some possible indicators in relation to redeployed employees, investments in local small- and medium-sized enterprises, or customers benefiting from financial aid and energy efficient homes. It asserted that "the financing tool could be applied to supporting just transitions, assuming that appropriate KPIs could be applied."

We recognise that the development of appropriate just transition metrics is in its infancy. Indeed, it is one of the areas of research in which the Just Transition Finance Lab is engaged. Metrics that enable companies and investors alike to demonstrate positive impact around just transitions could prove an important tool in helping finance flow – and in holding companies and investors to account.

11. *Social KPIs matter: setting robust indicators for sustainability-linked finance*, IFC, 2023

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