

# Managed Decline of Fossil Fuel Businesses

A Net Zero World is Fossil Free



**DivestInvest**

# DivestInvest

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Front page Artwork:

John Gerrard

Western Flag, 2017

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This paper is primarily aimed at investors who are considering divestment of companies which have fossil fuel extractive business units.

The aims of the paper are threefold:

**1 To provide criteria to help investors to decide which coal, oil or gas companies should be divested from, or reinvested in**

Common approaches to divestment are to exclude the entire oil and gas sector, or exclude any company with fossil fuel reserves. Some investors find these problematic because they do not acknowledge some companies may transition. This paper provides a more nuanced approach which allows investors to assess the extent to which individual fossil fuel companies can be considered to be transitioning or not, and therefore suitable for divestment or reinvestment. Investors can adopt a policy which states they will not invest in fossil fuel companies which fail to achieve the criteria.

**2 To improve investor engagement strategies by using the criteria as the basis for engagement strategy**

Investor engagement efforts to date have, with some important exceptions, tended to focus on asking companies to do specific actions at a particular time (e.g. disclose risks) or had asks which are too broad or subjective (e.g. "align with the Paris Agreement"). This paper seeks to find an effective middle ground, with objective criteria that can form the goals of any engagement. If the

**“ A PROHIBITION OF INVESTMENT WOULD BE AN EFFECTIVE SOLUTION TO REACHING A FOSSIL FREE WORLD”**

*Amin Nasser CEO of Saudi Aramco<sup>1</sup>*

**”**

companies are not achieving the criteria set out here by a certain date, investors can assess that the engagement is not successful, and that they should divest.

**3 To improve the impact of divestment by providing clear asks of companies when investors divest**

All the criteria to assess companies flow from the recognition that to address the climate crisis, we need an immediate managed decline of fossil fuel exploration and infrastructure<sup>2</sup>.

This need for managed decline is currently not adequately communicated by investors, or indeed their advisors or advocacy groups. By making these asks more central to their divestment announcements, investors can help support the shift to managed decline. This approach also helps to make divestment a form of public engagement with the fossil fuel companies.

We hope that as investors start to communicate the need for these actions from companies it will encourage policy makers to focus more on supply side policies and take more decisive action to change the business plans of companies not acting.

**“ IN OUR VIEW  
THE MOST SHARE-  
HOLDER-FRIENDLY  
OPTION IS TO MAKE  
A COMMITMENT  
NOW TO A MANAGED  
DECLINE.”**

*Nick Stansbury, fund manager at  
Legal & General on Shell.<sup>3</sup>*

**”**

### The criteria

1. No lobbying for policies that reduce the probability of the 1.5°C goal.
2. No exploration spending.
3. No approval or acquisition of new fossil fuel infrastructure or projects.
4. A clear plan for wind down of fossil fuel extraction.
5. Remuneration policies that support managed decline of fossil fuel extraction.

The criteria build on the work of many others, including the Transition Pathway Initiative (TPI) the Oxford Martin Principles (OMP). This paper seeks to align with the OMP while providing more specific criteria to help operationalize the principles. And it seeks to fill a gap left by approaches such as the Transition Pathway Initiative whose authors' acknowledge their methodology has limited ability to assess companies looking to winding down fossil fuel business units<sup>4</sup>. We are pleased to acknowledge that the criteria in this paper are aligned to similar criteria developed by WWF<sup>5</sup>.

The five criteria that follow set out a means to assess whether companies are on track for delivering the managed decline pathway, and therefore are aligned with the Paris Goals. All these criteria would need to be fulfilled for any current fossil fuel related company to be included in an asset management product related to the DivestInvest pledge.

### 2.1. NO LOBBYING: DO NOT MANAGE BUSINESS RISK FROM CLIMATE GOALS BY OPPOSING THE GOALS.

Lobbying is about how a corporation can influence the policy process. This can be done with the aim of influencing specific policies or the views of society more broadly to maintain their social and legal license to continue operating fossil fuel assets.

Fossil fuel lobbying includes a range of activities such as campaign donations to politicians, public relations effort such as supporting museums, education, major outdoor advertising budget in airports and government quarters in cities with significant political institutions. It may

also include spreading disinformation such as “fossil gas is a transition fuel needed to balance renewables”, “fossil fuels are essential to stop energy poverty”, “the world needs to balance the dual challenge of climate and energy needs”, rather than telling the right stories that “renewables can be balanced in batteries and stored heat and cooling”, “fuel free energy is cheaper for the poor than fuel based”, and “the world’s energy challenge must be met within the carbon budget”. Getting a full overview of fossil fuel lobbying is a complex task and many investors addressing this challenge are inspired by the work by Influence Map<sup>6</sup> and the Union of Concerned Scientists<sup>7</sup>.

A company should:

- Be transparent about which groups they support and make public statements where groups supported take positions that conflict with the company’s policy.
- Withdraw membership of trade associations where positions taken conflict with those of the company
- Ensure communications under their influence do not contradict or undermine the need to urgently transition to systems using renewable energy and bring about a managed decline of fossil fuels



▲ Figure 1: Advertising can be part of a lobbying effort.



▲ Figure 2: Historic Oil Exploration  
Canoe trek on the Athabasca River as part of one of the Karl Clark oil field expeditions, 1920s<sup>8</sup>.

## 2.2. NO NEW EXPLORATION SPENDING

The world already has more fossil fuel reserves than can be safely burnt. Expenditure on new exploration is unneeded and fully within the control of company management. Any company that has expenditure on exploring new fossil fuels is not integrating climate enough to be included in a climate safe 1.5°C Paris Aligned portfolio.

The company should immediately make explicit commitments around ceasing explorations. These should cover all regions and types of assets and set out timelines to wind down these activities over less than 3-5 years.

## 2.3. NO APPROVAL OF NEW FOSSIL FUEL INFRASTRUCTURE

As discussed in section 4 in this paper there is no room for new supply within a safe pathway to net zero emissions. Therefore, no new fossil fuel extraction or transportation infrastructure should be built, and some fields and mines should be closed before fully exploiting their resources. Thus, company management should never sanction the construction of new fossil fuel projects.

Additionally, because the world already has more fossil infrastructure to extract more than it can safely burn, unfinished fossil fuel infrastructure has no climate safe value and company management should not acquire it with the purpose of finishing it to make it able to extract fossil fuels.

## 2.4. A CLEAR PLAN FOR WINDING DOWN FOSSIL FUEL ASSETS

In addition to stopping new exploration and extraction, companies must have a plan for existing fossil fuel assets to be wound down.

This should not be to sell them off with the expectation that others would continue to extract from them.

This should cover issues regarding:

- the just transition, so that the social issues with this change are also addressed properly;
- the industry standard focus on minimizing operational emissions until phaseout;
- a clear wind down date of the first facilities within a 3-5-year period and
- after this a wind down rate at or higher than the one needed to reach no extraction in 2040.
- The Carbon Budget used by extracted fossils until reaching no extraction.

This paper has no opinion on how management chooses to deliver this. Proposals have included returning cash to shareholders and closing the company down or invest such cash in alternative climate compliant business units. Management has significant freedom in choosing how to provide value for shareholders with a fossil fuel business unit in managed decline.

## 2.5. REMUNERATION POLICIES THAT SUPPORT MANAGED DECLINE

Company boards can influence the everyday decisions of executives through their incentive and remuneration package. Therefore, it is essential that the above criteria need to be reflected in the incentive package. This might include a strong focus on delivering successful shut downs and decommissioning. It would not include incentives for activities contrary to a managed decline, such as bringing new extraction projects on line, increasing the market for natural gas or promoting narratives regarding increasing oil and gas demand.

Remuneration is critical to ensure that senior management's incentives are aligned with Managed Decline. One should beware that many remuneration policies have conflicting incentives: e.g. both achieve climate targets and to increase sales volumes of fossil fuels or delivery new fossil fuel extraction projects<sup>9</sup>. A remuneration scheme that supports a managed decline strategy obviously cannot incentivize fossil fuel sales and new fossil fuel extraction.

## 2.6. REAL WORLD EXAMPLES OF MANAGED DECLINE

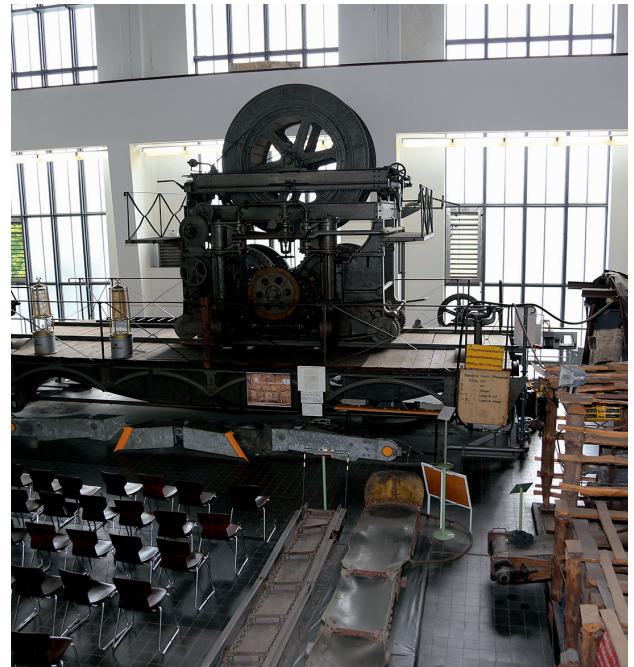
There are to our knowledge no non-renewable energy companies, such as coal, oil, and gas companies, which have explicitly and fully implemented all these criteria. This is a reason why the divestment movement can confidently go against all existing fossil fuel companies.



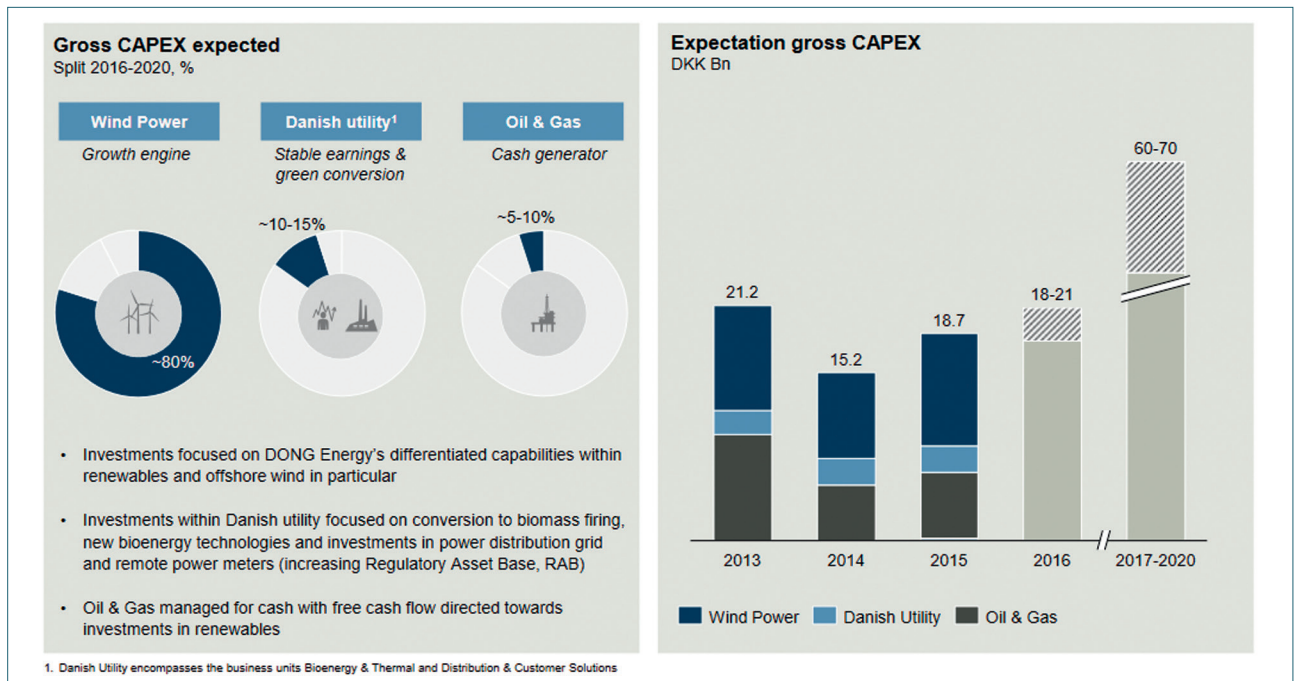
There are, however a few examples of (former) fossil fuel companies, which are close. These include Ørsted and TUI.

A few years ago, Ørsted – at the time partially owned by Goldman Sachs - wrote in a strategic review of its extraction business: *"Going forward, the cash flows from E&P [oil & gas exploration and production] will be part of funding [Ørsted's] investments in renewable energy ... With this revision of [Ørsted's] portfolio strategy, investments to support future growth will be focused on renewable energy<sup>10</sup>".*

TUI travel, which is one of Europe's largest leisure travel groups, is an example of a company, which has transitioned away from coal. This company was originally founded as the coal mining company Preussag, but has not been involved in fossil fuel extraction for decades now<sup>11</sup>.



▲ Figure 3: Ibbenbüren Mining Museum. Preussag built a power plant in Ibbenbüren in 1954. The Ibbenbüren coal mine was closed in December 2018.



▲ Figure 4: In the Initial Public Offering of Ørsted, Wind Power was presented as the growth engine, which accounted for 80 pc. of Capex, while the historic Oil & Gas business unit was presented as a cash generator, which accounted for 5-10 pc. of Capex.

### 3.1. STRATEGIC INVESTOR ENGAGEMENT

Climate Action 100+ is an investor initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.<sup>12</sup>

The goal is to get companies secure "robust company strategies aligned with the Paris Agreement".

The investors are asking companies to:

1. Implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risks and opportunities;

2. Take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2 degrees Celsius above pre-industrial level;
3. Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and, when applicable, sector-specific Global Investor Coalition on Climate Change Investor Expectations on Climate Change [1] to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below 2-degrees Celsius, and improve investment decision-making.

**Climate Action 100+**  
Global Investors Driving Business Transition

[www.climateaction100.org](http://www.climateaction100.org)

Index ▲1.56 ▼0.78

Investors from around the world will ask companies to:

1. Implement a strong governance framework
2. Take action to reduce greenhouse gas emissions across their value chain
3. Provide enhanced corporate disclosure in line with the TCFD recommendations



▲ Figure 5: The ClimateAction 100+ as it presents itself.

The five Managed Decline criteria listed in this paper can be seen as complimentary to the CA100 asks and provide a helpful level of specificity to avoid misunderstanding, as occurred in the 2019 joint statement between BP and investors.<sup>13</sup>

Given the fundamental need for managed decline, we would encourage the CA100+ to be specific about this and adopt the above criteria here as the overall objective of the initiative. This might include the initiative making a public request of all fossil fuel companies to comply with the criteria.

Investors should also consider what action they will take if companies do not align with the criteria after a certain timeframe. Some will vote against the boards, and/or divest. It is for them to decide the most appropriate tools they have at their disposal to achieve the managed decline required.

### 3.2. TRANSPARENT LOBBYING OF GOVERNMENT

Governments are looking for signals from the private sector. The 2014/1015 Global Investor Statement on Climate Change”, signed by 409 investors with \$24 trillion includes the commitment *“to work with policy makers to support and inform their efforts to develop and implement policy measures that encourage capital deployment at scale to finance the transition to a low carbon economy and encourage investment in climate change adaptation”*<sup>14</sup>

By publicly calling for managed decline, investors can engage with policy makers and persuade them to bring about suitable policies, thereby helping to stop climate change and making the investment process easier. Also, by making sure that companies are implementing a managed decline strategy the risk of loss is smaller when governments do implement the policies called for by investors and civil society to solve the climate crisis. When investors invest in a way that indicates an expectation that that governments do as called for, they make it easier for governments to pass the policies. Reducing investment in fossil fuels will make it easier for politicians to pass a meaningful carbon price or other policies, that will ensure that the Paris climate goals are met.



▲ Figure 6: Political leaders are calling for carbon neutrality in a few decades.

### 3.3. IMPLEMENTING DIVESTMENT

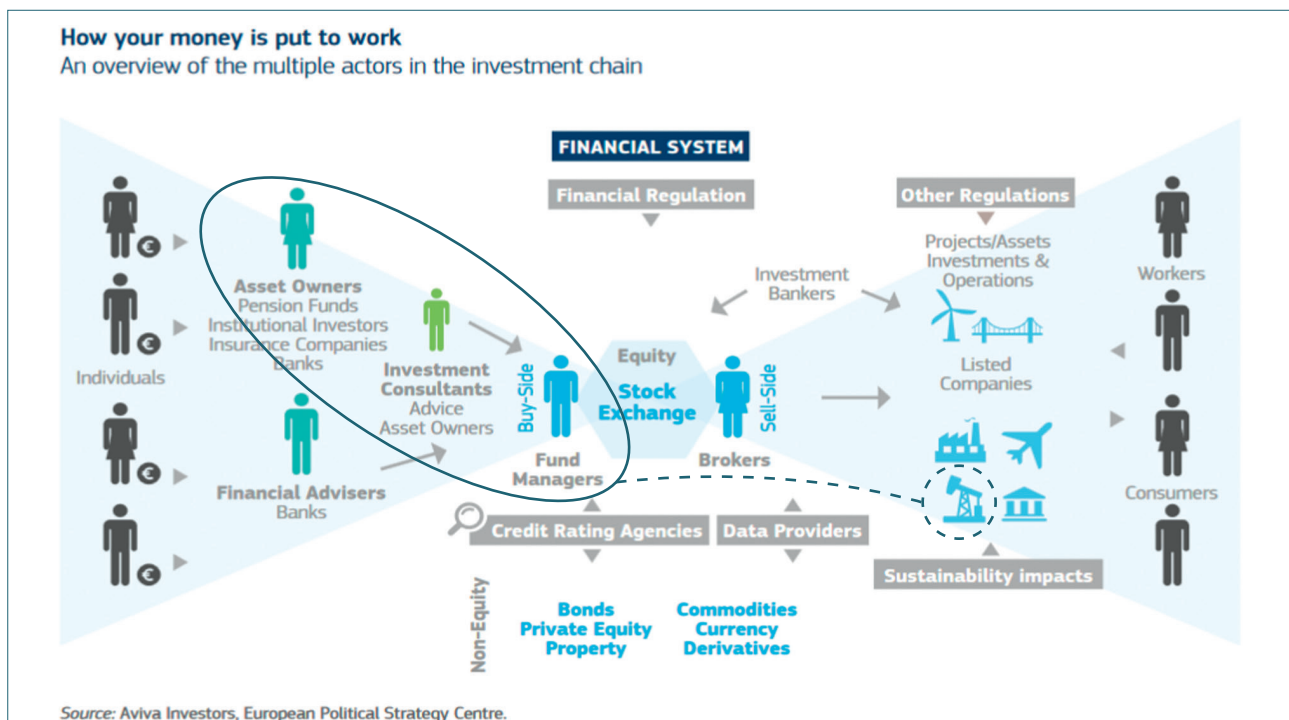
Investors who are choosing to divest tend to use one of three approaches to exclude companies: they own reserves; they have a certain amount of revenue from fossil fuels; or by their classification in industry sub sectors.

The criteria can be complimentary to all the approaches. Investors may decide to take a high level position to exclude companies by one of the above rationales, and then consider reinvesting if the Managed Decline criteria are clearly met.

Asset managers could also apply the criteria to assess any company in their portfolio. The criteria should therefore

help grow the market for fossil free asset management by setting criteria within which fossil free asset management products can be further developed. Within such criteria one can imagine a competitive market of asset management solutions that make finance flows consistent with a managed decline of fossil fuels.

Asset managers might wish to market their products with a claim that they are consistent with DivestInvest principles. This should be encouraged, although the DivestInvest network at this point has no structure to verify such claims. Asset owners and their investment consultants should verify such claims as part of their due diligence in choosing asset management products.



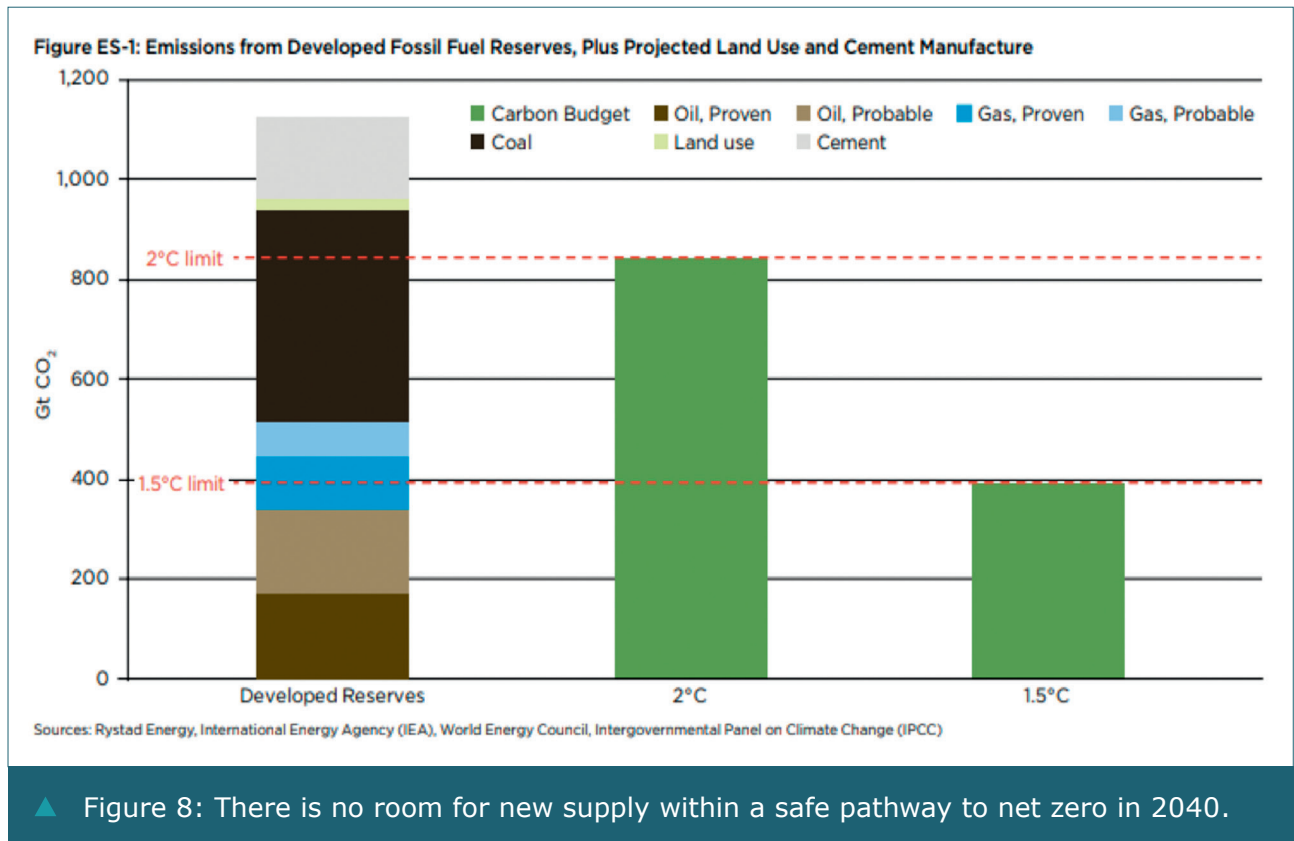
▲ Figure 7: Divestment can be implemented in the market for mandates between asset owners and asset managers. These criteria explicitly links this implementation to Companies' Fossil Fuel Supply Assets.<sup>14a</sup>

# 4

## PARIS CLIMATE GOALS REQUIRE A MANAGED DECLINE

The potential carbon emissions from the oil, gas, and coal in the world’s currently operating fields and mines would take us beyond 2°C of warming, and the reserves in oil and gas fields currently in operation, even with no coal, would take the world beyond 1.5°C.<sup>15</sup>

The logical conclusion therefore is that no new fossil fuel extraction or transportation infrastructure should be built, and that existing fields and mines should be closed before fully exploiting their content. This will require a managed decline of this fossil fuel extraction to cessation.



DivestInvest is a source of debate on the climate change risks supplied by fossil fuels. In this annex some of the arguments from this debate are consolidated into a headline statement, followed by our DivestInvest counterargument to such statement.

### A.1.1 “OUR CLIMATE SCENARIOS SHOW THAT THERE IS ROOM FOR MORE EXTRACTION”

Following the TCFD recommendations, many investors are now looking to do scenario analysis to assess whether their companies are Paris Aligned. A number of think tanks and academic institutions have developed tools to support this, including The Paris Agreement Capital Transition Assessment (PACTA), The Transition Pathway Initiative (TPI) and 2 Degrees of Separation by Carbon Tracker and PRI<sup>16</sup>.

The recommendations of these tools can indicate there is scope for additional fossil fuels in portfolios. However, this is due to two simple reasons that investors can easily resolve: many of the tools only use 2C, not 1.5°C as the IPCC Special report encourage us to do, and more problematically, at the time of writing, these and similar approaches tend to use scenarios from the International Energy Agency which investors widely acknowledge is not fit for purpose<sup>17</sup>. There are three principle reasons for this. First, too large a carbon budget. Second, relying on negative emissions. Third, a tendency to undervalue the price competitiveness of non fossil fuel energy sources over time. This is not to fault the methodologies of investor guidance but

simply to acknowledge that investors who wish to use the tools need to additionally factor in a managed decline of fossil fuels.

The financial think tank Carbon Tracker, which has developed several seminal contributions at the interplay between climate, financial market actors, and fossil fuel supply has argued that a “Paris compliant” company would commit to only sanctioning projects that are sufficiently low cost to fit within a given low carbon budget, announce its intention to do so, and demonstrate this in action<sup>18</sup>. We do not disagree with this in theory. The difference is simply that the carbon budget is smaller in using a 1.5°C goal, hence there are no projects that can fit, however cheap.

### A.1.2. “WE CAN GRADUALLY PHASE OUT EXISTING ASSETS, BUT DON’T NEED TO CLOSE DOWN EXISTING INFRASTRUCTURE.”

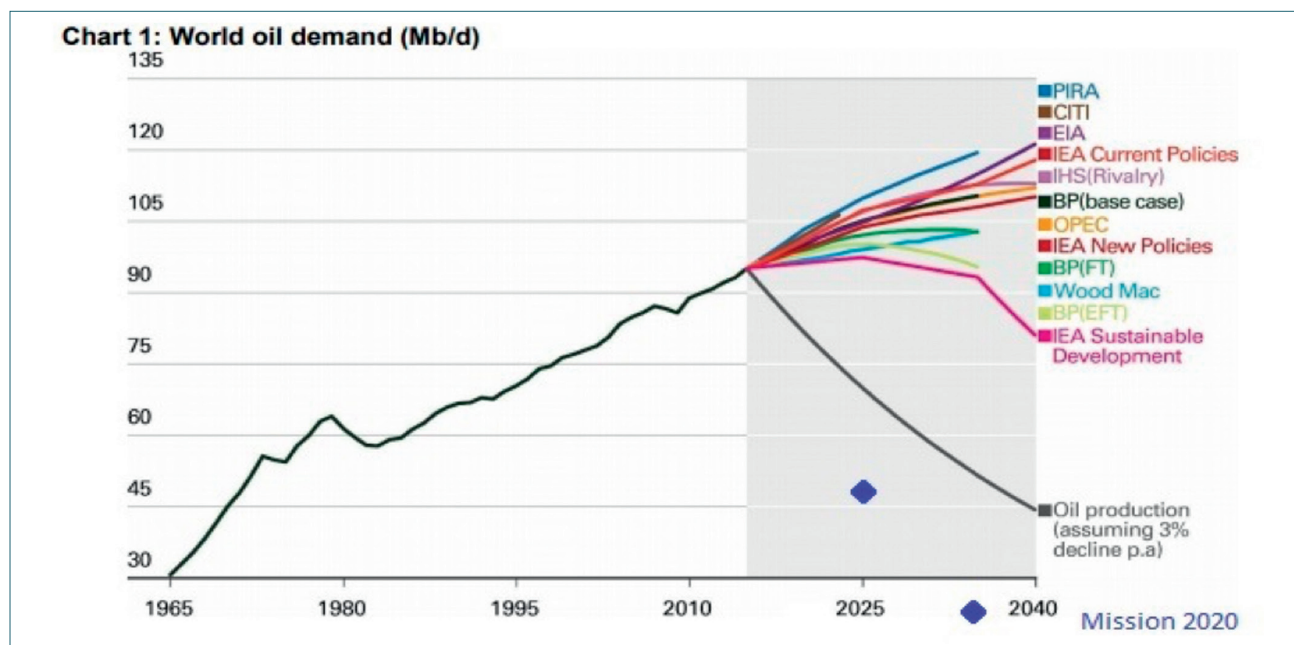
Managed decline is not simply a matter of stopping investing in new infrastructure, as this would itself not achieve a sufficient reduction: According to BP’s chief economist Spencer Dale, a broadly accepted rule of thumb is that production will decline at 3 pc. per year, if no investment is made in new infrastructure<sup>19</sup>. A 3 pc. decline is equivalent to a reduction of about 26 pc. in a decade of fossil fuels extracted and burnt. While this would mean an important difference for the climate, it is not enough for the climate according to Johan Rockström et. al,<sup>20</sup> who helped

introduce the ambitious Mission2020 initiative. They introduce a simple heuristic that emissions from burning fossil fuels need to decline by 50 pc. per decade, regardless of base year. The IPCC Special report from October 2018 calls for "decline by about 45 pc. from 2010 levels by 2030".

Chart 1 comes from a recent paper from the oil industry. Three points are illustrated by this chart:

1. All industry scenarios including scenarios such as IEA's Sustainable Development Scenario or BPs Faster Transition or Even Faster Transition have expected volumes above the 3 pc. decline a year line. This is the industry's justification of building new projects.

2. The climate safe heuristic developed by Johan Rockström has volumes below the 3 pc. decline a year line. This would indicate that it is not enough just to stop new projects and rely on the natural decline rate of existing project. One would have to manage the close down of existing extraction facilities, that would leave some of their fossils in the ground.
3. The climate safe heuristic will take volumes lower than 30 million barrels a day before 2040. Yet the industry chart has a cut off that does not allow to show such low volumes in the period until 2040. The climate safe pathway is literally off the industry chart.



▲ Figure 9: Adapted from Dale, Spencer and Bassam Fattouth: Peak Oil Demand and Long-Run Oil Prices, Oxford Institute for Energy Studies, Energy Insight: 25. January 2018<sup>21</sup>.

"Mission 2020" (the two diamond dots) has been added to the original based on: Rockström, J., Gaffney, O., Rogelj, J. et. al. 2017. A roadmap for rapid decarbonization. Science, Volume 355 Issue 6331.

IPCC Special report from October 2018 calls for "decline by about 45 pc. from 2010 levels by 2030".

### A.1.3. “WE CAN USE CCS AND OTHER NEGATIVE EMISSIONS TECHNOLOGIES”

Imagining a role for fossil fuel extraction in a world with net zero emissions, however, assumes that negative emissions can be employed at a scale that can offset the carbon emissions.

There are two broad categories of negative emissions technologies: Those where carbon is stored in the earth’s soil or plants on it and those where carbon is stored using technology that can put the carbon deep into the Earth’s geology. The former work with Agriculture, Forestry and other Land Use (AFOLU), whereas the latter is often referred to as carbon capture and storage (CCS). CCS has not been proved at commercial scale at this point. There might also be limited capacity in the Earth’s geology for CCS.

#### **Within CCS one can distinguish between three kinds:**

**CCS for industry:** Some industry products such as cement create CO<sub>2</sub>, which does not derive from fossil fuels. This is thus a separate issue from managed decline of fossil fuels. To the extent such industry product cannot be substituted by other carbon neutral products, CCS can be a way of achieving carbon neutrality in such industries. This use of CCS technology would be carbon neutral, and not carbon negative.

**Bio Energy CCS (BECCS)** is a concept to achieve negative carbon emissions. By burning wood and storing the CO<sub>2</sub>

underground the land is supposedly freed up for new trees, which can absorb new carbon from the atmosphere. The land use assumptions for this, however, are challenged from biologists, and some scenarios include new forest in an area several times the size of India, which might seem a non-trivial task to deliver. There is therefore a need not to rely on BECCS. If BECCS can deliver it can be used to increase the probability of meeting the 1.5°C goal.

#### **CCS for oil and gas including**

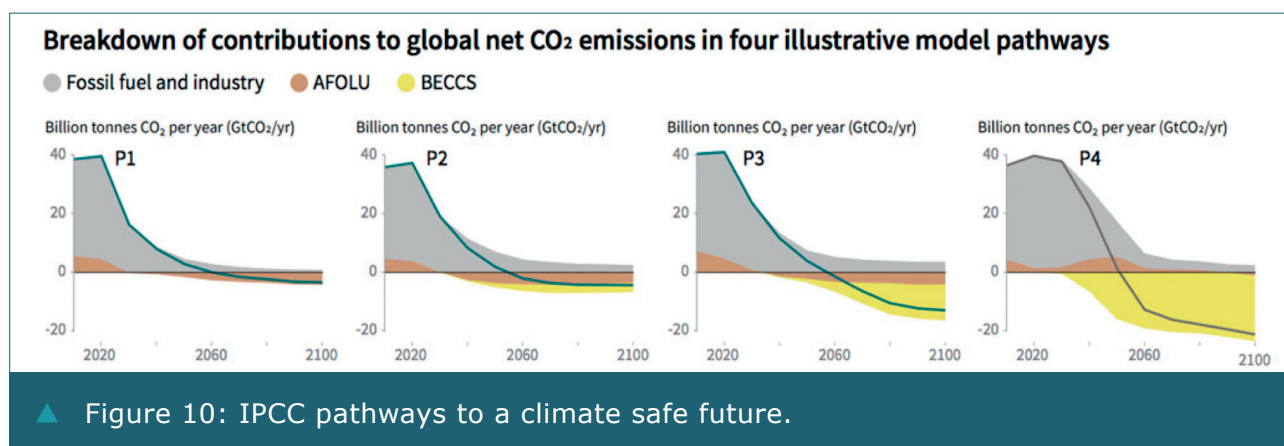
**petrochemicals:** This technology would include extracting carbon from the ground, changing its chemical composition and putting it back into the ground. It is an unproved technology, which if implemented would draw on the limited capacity for CCS of the Earth’s geology. Fossil carbon is most safely stored in the geology, where it has stayed out of the atmosphere for millions of years. Figure 6 reproduces the illustrative pathways to 1.5°C in the IPCC report, which do contain negative emission technologies.

As of 2019 BECCS is a concept that has not proven itself on commercial scale. In February 2019 the world’s first pilot project was put in operation removing 1 tonne of carbon dioxide a day<sup>22</sup>. Removing 1 tonne of CO<sub>2</sub> a day over an 80-year period from 2020 to 2100 would cumulatively remove approx. 30,000 tonnes of CO<sub>2</sub>. Pathway P2 in Figure 4 contains 151 billion tonnes of CO<sub>2</sub> to be removed by BECCS until 2100 This implies that BECCS should be scaled up on average over 2020-2100 by a factor of 5 million from the level running in 2019 for P2. For P3 the scale is a factor 14 million, and for P4 40 million.



Assuming such a giant scale up of an unproved technology seems highly risky, so P1 would seem to be the only proven pathway. This pathway requires a rapid managed decline of fossil fuel use. Yet this pathway relies on fossil fuels up to

2060 and thus has a need for negative emissions from the land use sector. Ceasing fossil fuels by 2040 will all other things equal increase the probability of staying within the 1.5°C threshold.



Even if one were to work more with negative emissions one would have to assume that it is technologically possible to build a negative emissions industry<sup>23</sup>, which would need the following properties.

1. It should have the technical capacity to safely offset all emissions coming from all fossil fuels with sufficiently low land use.
2. It should be properly governed, regulated, and monitored to avoid fraud etc.
3. It should have a viable revenue model, so the people working in this industry can earn wages.

These conditions are not met. Indeed, even according to the IEA' Tracking Clean Energy Progress (2018) negative emission technologies such as CCS are not on track. In these circumstances the way to net zero must mean gross zero for energy and transport leaving the limited capacity for negative emissions for land use, cement, and cleaning up historic carbon pollution.

#### A.1.4. “THE CARBON INTENSITY METRIC WILL GUIDE OIL AND GAS COMPANIES TO MEET THE PARIS CLIMATE GOALS”

Some investors groups seek to pursue an objective of carbon intensity reductions, rather than complete decarbonization<sup>24</sup>. The Transition Pathway Initiative (TPI), which has received interest in the investor community, uses this in its so-called Sectoral Decarbonisation Approach (SDA). This approach works with the Carbon Performance metrics and for the oil and gas sector this initiative’s metric is the carbon intensity of energy supply<sup>25</sup>.

Carbon intensity has been agreed by some oil companies with investors, but it is unsuitable. Intensity can be reduced in a number of ways, e.g. lowering flaring, increasing renewable-energy output, shifting from oil to gas, none of which achieve the zero emissions economy we need. Indeed, it is perfectly plausible to see rising absolute emissions, while carbon intensity is falling, if absolute energy production is rising more.

Furthermore, the TPI acknowledges that its methodology is unable to assess companies based on managed decline criteria. *“Our current methodology has limited ability to assess companies responding via strategies (3) [Shift hydrocarbon sales away from energy markets into plastics and petrochemicals] or (4) [Cut investment in new hydrocarbon production assets, exploit existing production assets and return profits to shareholders, perhaps eventually winding up the business]. Strategy (3) would reduce absolute emissions without reducing emissions intensity, as non-energy products are stripped out of the emissions intensity calculation. Likewise, in strategy (4), falling production levels would effectively reduce the absolute volume of CO<sub>2</sub> released, but the emissions intensity of energy production may remain constant.”*

Indeed, TPI actively encourage investors to use other forms of assessment. *“We could expand our methodology to encompass these other strategies, should it be required, and it may also be desirable for investors to use TPI’s assessment alongside other, complementary forms of assessment.”*<sup>26</sup> We invite investors who use the TPI methodology to adopt our criteria.

### **A.1.5. “MANAGED DECLINE IS TOO SPECIFIC, WE SHOULD LET OIL COMPANIES DECIDE HOW THEY ALIGN WITH PARIS GOALS”**

Some groups are content leaving it to oil companies themselves to decide how to achieve the Paris goals; that as long as they agree to do this, investors have done their job.

The fact that there is such confusion among investors, investee companies, and wider society about what is actually involved in Paris compliance should be proof enough that this additional layer of specificity outlined in the paper is required.

It may be that investors prefer to simply ask companies to align with Paris rather than go into this greater level of detail. This is a matter for specific investors. We would argue at a strategic level, it is essential to articulate these Managed Decline criteria are the eventual objective of any investor tactic.

As the divestment movement has grown, investors are looking for guidance on what they should divest from. To some extent, it is a matter for the individual investor given the factors driving such a decision – financial concerns, responding to stakeholder pressure, moral compulsion and so on - are so varied. Most investors have taken one of three approaches to date: exclude companies by size of reserves; by turnover; or by industry sub sector. These criteria can be used in combination with any of these approaches to develop a more granular approach and potentially be used in combination with policy engagement, i.e. investors could divest and then encourage other investors, government and oil companies themselves to align with the criteria in order that they then reinvest in them.

### A.2.1 FOSSIL FUEL RESERVES THRESHOLD

It is quite common for investors, who have taken the DivestInvest pledge to exclude companies that own fossil fuel reserves from investment.

The Carbon Underground 200 list is a broadly used example of this approach. It is a regularly updated list of companies with the largest fossil fuel reserves.

The downside of the CU200 is that some investors find the cut off point arbitrary. At the other end of the spectrum, some investors exclude all companies with any reserves at all. This threshold is easier to apply but it does mean a handful of companies, including in renewables, with legacy assets are excluded. For most, it

is sufficient to exclude these companies. It is possible to identify all companies with fossil fuel reserves. Investors could exclude all of them or hold onto those with legacy assets and engage them to comply with the criteria.

### A.2.2 TURNOVER THRESHOLD

Another common approach to defining fossil fuels companies includes a focus on the fossil fuel revenue.

Often there will be a cut off at a percentage of turn over e.g. that companies deriving more than 5 pc. of turnover from fossil fuels are excluded. As most business strategies must generate revenue the criterion does put attention on the quantity, but the criteria are sensitive to two factors, which are not climate relevant:

1. The price of the fossil fuels sold.
2. The total composition of business units in the company.

I.e. if a small company with 100 pc. of revenue from extraction were acquired by a more than 20 times larger company the business would suddenly change from unacceptable to acceptable on these criteria, although nothing has changed in terms of fossil fuels extracted and influencing the climate.

Investors should use this paper's criteria to engage with the company involved in the acquisition.

### A.2.3 SUB-SECTOR BASED EXCLUSIONS

Some investors exclude companies based on industry classifications. This is particularly attractive to passive investors<sup>27</sup>.

Investors could use the criteria to inform a decision to take companies off an exclusion list if they reform.

The classification is based on revenue so the approach is subject to problems associated with a turnover approach.

Examples of divestment based on sub-sector classification:

#### EX FTSE DIVESTINVEST INDEX SERIES

All constituent securities of the eligible universes are eligible for inclusion in the FTSE Divest-Invest Index except for securities in the following sectors and subsectors of the Industrial Classification Benchmark (ICB) System which are ineligible for inclusion:

- Oil & Gas Producers (ICB 0530)
- Oil Equipment, Services & Distribution (ICB 0570)
- Coal (ICB 1771); and
- General Mining (ICB 1775)

#### EX FTSE EX FOSSIL FUELS INDEX SERIES

**Excluded Companies:** An Excluded Company is one whose business activity is identified by the Standard Industrial Classification 1 (SIC) System.

A company is categorized as an Excluded Company if it either has:

- revenues arising from Bituminous Coal and Lignite Surface Mining (SIC code: 1221),
- Bituminous Coal Underground Mining (SIC code: 1222),
- Anthracite Mining (SIC code 1231),
- Crude Petroleum and Natural Gas (SIC code: 1311) and
- Natural Gas Liquids (SIC code: 1321)
- based on the companies' most recent published Annual Report and Accounts;
- or proved & probable reserves in coal, oil or gas based on the companies' most recent published Annual Report and Accounts.

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DivestInvest is about divesting from fossil fuels and investing in climate solutions. We'll only solve climate change by moving quickly from fossil fuels to sustainable energy. This paper is primarily aimed at investors who are considering divestment of companies which have fossil fuel extractive business units.

The aims of the paper are threefold: To provide criteria to help investors to decide which coal, oil or gas companies should be divested from, or reinvested in; To improve investor engagement strategies by using the criteria as the basis for engagement strategy; To improve the impact of divestment and engagement by providing clear asks of companies when investors divest.

The criteria:

1. No lobbying for policies that reduce the probability of the 1.5°C goal.
2. No exploration spending.
3. No approval or acquisition of new fossil fuel infrastructure or projects.
4. A clear plan for wind down of fossil fuel extraction.
5. Remuneration policies that support managed decline of fossil fuel extraction.

The criteria build on the work of many others as we are happy to acknowledge.