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Report on Engagement Limitations When Tackling the Systemic Issue of the Fossil Fuel Industry's Connection to Climate Change: Case Study for Strathclyde Pension Fund

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On August 31, 2015, Strathclyde Pension Fund committee rejected Glasgow City Council's proposed resolution on fund's divestment from fossil fuel industries. The feasibility of such act was reviewed and dismissed on grounds of **engagement,** stating that active engagement with fossil fuel companies will address the subject of climate change in more efficient way[1]. In the following report we discuss the main issues and present case studies, demonstrating that engagement is ineffective as a solution to limit the impacts of climate change and comply with recently internationally agreed climate targets.

Strathclyde Pension Fund (SPF) is a signatory of the United Nations Principles for Responsible Investment (PRI), which holds its managers accountable for investing into environmentally, socially and governmentally (ESG) aware corporations or to engage with companies and strive to improve their practices. Since 2012, SPF entrusts this commitment to GES (Global Engagement Services), the European Union's leading provider of engagement services - engaging with different companies on behalf of their investors[2]. Strathclyde Pension Fund Committee claims that climate change and its impacts have been highly incorporated in their Responsible Investment Strategy, with 14% of annual engagements related to climate change, 12% of which were made directly by GES to energy companies on behalf of the fund. Additionally, the fund follows a direct engagement approach by building alliances with other investors such as Local Authority Pension Fund Forum (LAPFF), ShareAction and Carbon Action.

[1] Glasgow City Council, Strathclyde Pension Fund Committee, Report on Feasibility of Fossil Fuel Divestment, 31st August, 2015.
http://www.glasgow.gov.uk/Councillorsandcommittees/viewSelectedDocument.asp?c=P62AFQDNT1DNUTDNZL
[2] Glasgow City Council, Strathclyde Pension Fund Committee, Report on Responsible Investment, 7th March, 2016.
http://www.glasgow.gov.uk/councillorsandcommittees/viewDoc.asp?c=P62AFQDNT1Z30GDNZL

Although, the aforementioned approaches did achieve some corporate change at certain levels - examples of which will be presented below - the engagement process with fossil fuel corporations is generally invalid due to several reasons:

1. The financial crisis faced by fossil fuel industries that is generated by stranded assets and the 'carbon bubble' cannot be addressed through engagement. As **financial risks** of investing into fossil fuels are emerging and becoming clearer every day, the managing body of Strathclyde Pension Fund has the responsibility to fulfill its **fiduciary duty** to its members and to make prudent decisions regarding the level of risk it exposes them to.

2. Although engagement may improve the practices of fossil fuel corporations, it is inadequate to prevent them to carry out their **core activity** of producing fossil fuels, which is the main driver of climate change and the main concern of many shareholders. Moreover, as argued by Carbon Tracker Initiative, engagement and divestment from fossil fuels are intimately linked when meaningfully addressing the issue of climate change: *'true engagement needs the pressure created by divestment. Engagement without divestment is like a criminal legal system without a police force.'*[3]

3. Although globally recognised, climate change is still denied by most of the fossil fuel corporations, which leads to disapproval of governments' set targets to reduce impacts of climate change and do not cross critical 2ºC target. This is leading to the expansion of the industry and further wreckage of the environment, rather than a step back and aim to change its practices.

FINANCIAL RISKS

International recognition of climate change and the limited carbon budget have not put fossil fuel companies at ease. The IPCC (Intergovernmental Panel for Climate Change) reports that to have at least a 50% chance of meeting the agreed 2ºC target, no more than 1120 GtCO2 can be emitted. The claimed fossil fuel reserves, on the other hand, correspond to 2860 GtCO2, which is more than double the global carbon budget[4]. Following this, the IHS, leading company in supporting bussiness and governments decision making processes, has stated: '*The intrinsic value of most publicly traded oil and gas companies is based primarily on the valuation of proved reserves—90% of which are expected to be monetized in 10 to 15 years*.' This concept of 'carbon bubble' is widely recognised as a financial threat to fossil fuel industries – as the social, political and economical pressures, which they are facing, make the bursting of that bubble increasingly more imminent.

[3] Carbon Tracker Initiative,*Gone Fishing: Divestment and Engagement* http://www.carbontracker.org/divestment_engagement/

[4] OECD, *Divestment and Carbon Assets in the Low-carbon Transition* https://www.oecd.org/sd-roundtable/papersandpublications/Divestment%20and%20Stranded%20Assets%20in%20the%20Low-carbon%20Economy%2032nd%20OECD%20RTSD.pdf

Subsequently, the industry is already confronting economical issues, and exposing its shareholders to great financial risks, which cannot be resolved through engagement. The IEA (International Energy Agency) scenario for stranded assets estimates 304 billion USD of non-recoverable investments by 2035. Furthermore, research conducted by Oxford University has shown that 6 billion EUR have already been lost through stranded assets in gas plants by 2013[5]. Meanwhile, in 2014, fossil fuel corporations such as Shell, Total and Statoil have already been seen suspending massive oil sand projects, and Rio Tinto and BHPBilliton stopped new thermal coal projects – which should be a warning trigger to their shareholders[6]. More recently, Peabody, the largest coal company in the world, in which Strathclyde Pension Fund has invested over £136 thousand, has filed in for bankruptcy[7]. With the current crash of coal industry and the dramatic drop in oil prices, the fund has **already lost £26 million**[8] and is still exposed to future risks.

ENGAGEMENT AND FOSSIL FUELS

Recognising the urgency of climate change, SPF became a signatory of RE100 initiative, pressuring huge corporations such as Coca Cola Enterprise, Google, M&S, etc., to turn to 100% renewable companies for their energy needs[9]. Additionally, since the Mexico Gulf incident, through LAPFF and GES, the fund has been lobbying oil corporations such as BP, Rio Tinto and Shell to strive to improve their practices and prevent future incidents[10]. Even though this is an admirable move and GES or alliances of other investors can pressure giant oil, coal and gas corporations to extract its product in more responsible way (preventing oil spillages, improving worker's rights, etc.), this kind of engagement cannot prevent multinational giants from conducting their core business, and thus cannot address the main issue of climate change - continuing to rely on greenhouse gas producing fuels while the global carbon budget is increasingly tightening.

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[5] Ben Caldecott & Jeremy McDaniels, *Financial Dynamics of the Environment: Risks, Impacts, and Barriers to Resilience* https://www.environmental-finance.com/assets/files/2014-07-15%20UNEP-SSEE%20Working%20Paper%20-%20Financial%20Dynamics%20of%20the%20Environment.pdf

[6] Carbon Tracker Initiative,*Gone Fishing: Divestment and Engagement* http://www.carbontracker.org/divestment_engagement/

[7] Bloomberg, *Coal Slump Sends Mining Giant Peabody Energy Into Bankruptcy* http://www.bloomberg.com/news/articles/2016-04-13/peabody-majority-of-its-u-s-entities-file-for-chapter-11

[8] Guardian, *Millions Wiped off UK Local Government Pensions Due to Coal Crash Analysis Shows* http://www.theguardian.com/environment/2015/oct/12/millions-wiped-off-uk-local-government-pensions-due-to-coal-crash-analysis-shows

[9] Glasgow City Council, Strathclyde Pension Fund Committee, Report on Responsible Investment, 7th March, 2016. http://www.glasgow.gov.uk/councillorsandcommittees/viewDoc.asp?c=P62AFQDNT1Z30GDNZL

[10] Glasgow City Council, Strathclyde Pension Fund Committee, Report on Feasibility of Fossil Fuel Divestment, 31st August, 2015. http://www.glasgow.gov.uk/Councillorsandcommittees/viewSelectedDocument.asp?c=P62AFQDNT1DNUTDNZL

Understanding this, large foundations such as the Rockefeller Family[11], the Norwegian Sovereign Wealth Fund and AP4 (Swedish Pension Fund)[12], started demanding from oil giants such as ExxonMobil and Shell that they recognise the threat of climate change and transform their industries by investing into renewable energy. More recently, because of the lack of positive response, the aforementioned foundations took the decision to completely or partially divest[13]- proving once more engagement to be ineffective and divestment to be the rational choice. Yet, as Carbon Tracker Initiative points out[14], the end of fossil fuels extraction is not something that can happen overnight, and while divestment is bound to be the final goal of any trusted public body, engagement is acknowledged to be an important step on the road towards it.

'While the global community works to eliminate the use of fossil fuels, it makes little sense—financially or ethically—to continue holding investments in these companies. There is no sane rationale for companies to continue to explore for new sources of hydrocarbons. The science and intent enunciated by the Paris agreement cannot be more clear: far from finding additional sources of fossil fuels, we must keep most of the already discovered reserves in the ground if there is any hope for human and natural ecosystems to survive and thrive in the decades ahead.' – The Rockafeller Family Fund's Decision to Divest statement - http://www.rffund.org/divestment

LACK OF ACTION ON CLIMATE CHANGE

Rather than taking action on climate change by reforming their practices and despite several attempts by shareholders to actively engage with them, fossil fuel corporations invested vast amount of money for '*finding and developing more reserves and new ways of extracting them'*[15]. In the last year, 674 billion USD were spent by the top 200 oil, gas and coal companies on exploration for new reserves, under the assumption that '*the world will fail to limit global warming under 2ºC*'- openly casting doubt on the seriousness of governments' decisions to limit the impacts of climate change[16]. In 2015, this approach was further illustrated with Chevron's rejection of its shareholders' pledge to restructure its capital to dividends rather than the further exploration of resources[17]. Moreover, in 2001, Greenpeace together with 13.5% of BPs Amoco shareholders, launched a campaign demanding BP to disclose information on how are they exactly going to

[11] Bright Now, *Otherwise Engaged: is church engagement with fossil fuel companies working or is it time to disinvest?* http://brightnow.org.uk/wp-content/uploads/2013/08/Otherwise-engaged-is-church-engagement-with-fossil-fuel-companies-working-or-is-it-time-to-disinvest-for-web.pdf
[12] Carbon Tracker Initiative,*Gone Fishing: Divestment and Engagement* http://www.carbontracker.org/divestment_engagement/
[13] OECD, *Divestment and Carbon Assets in the Low-carbon Transition* https://www.oecd.org/sd-roundtable/papersandpublications/Divestment%20and%20Stranded%20Assets%20in%20the%20Low-carbon%20Economy%2032nd%20OECD%20RTSD.pdf
[14] Carbon Tracker Initiative,*Gone Fishing: Divestment and Engagement* http://www.carbontracker.org/divestment_engagement/
[15] Carbon Tracker Initiative, *Unburnable Carbon 2013: Wasted Capital and Stranded Assets* http://www.carbontracker.org/wp-content/uploads/2014/09/Unburnable-Carbon-2-Web-Version.pdf
[16] OECD, *Divestment and Carbon Assets in the Low-carbon Transition* https://www.oecd.org/sd-roundtable/papersandpublications/Divestment%20and%20Stranded%20Assets%20in%20the%20Low-carbon%20Economy%2032nd%20OECD%20RTSD.pdf
[17] Financial Times, *Is fossil fuel engagement all talk and no action?* http://www.ft.com/cms/s/0/650f1e06-0544-11e5-8612-00144feabdc0.html#axzz45u83r4TR

move 'beyond petroleum'[18]. The resolution was backed by 130 shareholders, totaling up 11 million shares, in an annual BPs AGM. However, it was rejected due to legal technicalities and as stated later by the campaigners: *'the company had not outlined to shareholders how it would manage this transition and what it would mean for the company's oil and gas investments which represent 99.9% of its total energy investments.'*, proving the company's lack of accountability to its investors.

In 2013, a collective of 70 of the world's biggest investors, with more than a $3 trillion of assets in total, asked 45 of the world's top oil, coal, gas and electricity producers to assess the financial risks, that their shareholders are exposed to as a result of their stranded assets[19]. The responses received were similar – corporations did acknowledge the importance of climate change, but claimed that none of their current or future reserves will become '*stranded*'. In response to this, Exxon released two risk assessment reports, stating that *"[W]e are confident that none of our hydrocarbon reserves are now or will become stranded."*[20] Moreover, in 2014 Shell stated: *"we do not believe that any of our proven reserves will become stranded – this is because we do not see governments taking the steps now that are consistent with the 2ºC scenario"*[21]. Similarly, Exxon's and BP's output projections are based on scenarios that lead to much greater emissions than what is required not to cross the 2ºC threshold and their future successes are measured in terms of expansion of their oil reserves.

Although, corporations as such, are attempting to 'green' their image by making marginal investments towards sustainable energy, funding the denial of climate change and calls on governments regulations to be dropped are still high on the agenda of oil, gas and coal companies. Exxon has recently been accused of, and is now being sued for concealing early reports that revealed the urgency of climate change in 1981[22]. What is more, recent research reveals that the biggest oil companies Exxon and Shell, together with trade lobbying groups, annually spend 115 million USD to undermine international **climate change legislations**[23]. In addition to Exxon's incident outlined above, the company has also repeatedly pressured for annulment of the Environmental Protection Agency's (EPA) Renewable Fuel Standards[24] and Greenhouse Gas Emission

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[18] Anastasia O'Rourke, 2003, *A New Politics of Engagement: Shareholder Activism For Corporate Social Responsibility.* Bus. Strat. Env. 12, 227-239.
http://onlinelibrary.wiley.com/doi/10.1002/bse.364/epdf

[19] CERES, *Investors ask fossil fuel companies to assess how bussiness plans fare in low carbon future*
http://www.ceres.org/issues/press/press-releases/investors-ask-fossil-fuel-companies-to-assess-how-business-plans-fare-in-low-carbon-future?searchterm=carbon+asset+risk

[20] ExxonMobil, *Energy and Carbon - Managing the Risks*
http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/report---energy-and-carbon---managing-the-risks.pdf

[21] Shell's Letter, May 16th, 2014. http://s02.static-shell.com/content/dam/shell-new/local/corporate/corporate/downloads/pdf/investor/presentations/2014/sri-web-response-climate-change-may14.pdf

[22] New York Times, *Pressure on Exxon Over Climate Change Intensifies With New Documents*
http://www.nytimes.com/2016/04/14/science/pressure-on-exxon-over-climate-change-intensifies-with-new-documents.html?_r=0

[23] InfluenceMap, *How much big oil spends on obstructive climate lobbying*
http://influencemap.org/site/data/000/172/Lobby_Spend_Report__April.pdf

[24] ExxonMobil, *Repeal the U.S. biofuels mandate*
http://corporate.exxonmobil.com/en/company/multimedia/the-lamp/repeal-the-us-biofuels-mandate

Standards[25]. In the run up to the UN Climate Talks in Paris in 2015, Shell alongside with BP, Statoil, Total and Eni openly addressed EU policy makers to oppose their suggested renewable energy strategy[26]. This was followed by numerous reports and consultations from Shell aiming to remove renewable energy and energy efficiency targets from the EU's agenda[27], proving once more that while investors are engaging and attempting to improve the green credentials of fossil fuel companies, the same corporations are simultaneously seeking to halt or slow down international agreements and national legislations.

Following financial and ethical arguments, as well as past experiences outlined above, we conclude that **engagement as a tool** to stop oil, gas and coal companies from profiting from their core activity – which is what is driving the climate change issue - and to make them socially and financially accountable to their shareholders is inherently flawed and **cannot be implemented**.

[25] Union of Concerned Scientists, *National Black Chamber of Commerce Report on Clean Power Plan* http://www.ucsusa.org/global-warming/fight-misinformation/national-black-chamber-commerce-study-clean-power-plan#.VxIJG9ThDIV

[26] Shell Global, *Oil And Gas Majors Call For Carbon Pricing* http://www.shell.com/media/news-and-media-releases/2015/oil-and-gas-majors-call-for-carbon-pricing.html#vanity-aHR0cDovL3d3dy5zaGVsbC5jb20vZ2xvYmFsL2Fib3V0c2hlbGwvbWVkaWEvbmV3cy1hbmQtbWVkaWEtcmVsZWFzZXMvMjAxNS9vaWwtYW5kLWdhcy1tYWpvcnMtY2FsbC1mb3ItY2FyYm9uLXByaWNpbmcuaHRtbA

[27] InfluenceMap, Shell- EU- ETS Consultation, July 10th, 2015. http://influencemap.org/site/data/000/063/Shell_EU_ETS_Consultation_July_10_2015.pdf