27. Climate change and fossil fuels: response to Memorial 32 (2017) and Conference reply

1. Introduction

1.1 The Joint Advisory Committee on the Ethics of Investment (JACEI) was established by the Methodist Conference to advise the Central Finance Board of the Methodist Church (CFB) of ethical considerations relating to investment. The CFB invests monies on behalf of Methodist organisations throughout the church. Full details of JACEI's work over the last year are contained in its Report to the Conference, a summary of which is contained elsewhere in the Conference Agenda.

This paper reports on the advice JACEI has given the CFB in the light of the Conference reply to Memorial 32 (2017) on climate change, and the Conference's reply (Appendix 1).

1.2 The 2017 Conference asked the Methodist Council to request JACEI to undertake further analysis of fossil fuel companies in the light of the Paris Agreement on climate change, and to recommend further disinvestments should it be found that oil and gas companies' business investment plans are not aligned with the objective to limit rises in average temperature to "*well below 2°C*".

1.3 JACEI and the CFB have reviewed the outlook for the fossil fuel sector. They developed a methodology for assessing companies in the light of a future where temperature rises are limited to "*well below 2°C*". This methodology was set out in a report received by the 2018 Conference (see Appendix 1). This methodology has been used to help analyse a number of fossil fuel companies, including those held in CFB-managed portfolios. On the basis of the CFB assessment, including engagement with companies, JACEI has advised the CFB on which companies it believes should be excluded from investment on these grounds. JACEI has also advised on which companies it believes merit some further engagement.

2. The warming world

2.1 Evidence continues to mount that the earth is warming and yet greenhouse gas emissions continue to rise. The scale of the effort required to reduce carbon emissions is vast yet while some steps have been taken they are nowhere near sufficient to meet the challenge.

The Intergovernmental Panel on Climate Change (IPCC) estimates that mean surface temperature is now 1°C above pre-industrial levels.[1] At the current rate, global warming is likely to reach 1.5°C between 2030 and 2050.[2] Unless drastic action is taken, it is likely to exceed 3°C. Even at increases of 1.5°C or 2°C, the changes to weather patterns and sea levels will be substantial and in some cases irreversible.

Limiting global warming to 2°C with at least 66% probability requires carbon emissions to fall from 2010 levels by 25% by 2030 in most IPCC pathways and reach net zero around 2070.

2.2 The International Energy Agency (IEA) and the International Renewable Energy Agency (IRENA) scenarios for energy production based on a 66% probability that global warming is limited to 2°C assume significant reductions in energy from fossil fuels.[3] The IEA 66% scenario assumes that by 2040 coal use will be at 1980s levels and the IRENA 66% scenario assumes coal production will be at 1960s levels by 2050.

[1] The Economist 21 September 2019: https://www.economist.com/briefing/2019/09/21/the-past-present-and-future-of-climate-change
[2] *Special report: global warming of 1.5C*, IPCC: https://www.ipcc.ch/sr15/
[3] https://www.iea.org/publications/insights/insightpublications/PerspectivesfortheEnergyTransition.pdf

The detailed outlook for oil is perhaps more debatable, with the scenarios acknowledging the lack of viable alternatives to oil fuels, particularly in parts of the transport sector such as aviation and haulage. This results in different projections for oil output in 2050.

2.3 On these scenarios, by the 2050s oil demand could be between 45% and 60% lower than 2015 levels. The outlook for natural gas power generation depends on whether a scenario assumes it should be used as a transition fuel. There is a shorter term environmental advantage from switching from oil and coal to gas, as CO_2 emissions from gas are approximately 40% lower than coal and approximately 20% lower than oil. However, the danger is that the reliance on gas for the longer term energy supply becomes too heavy, in such a way as to be inconsistent with the Paris Agreement. Either way, its usage would peak and begin declining before 2050 (IPCC).

2.4 To limit global warming by 1.5°C, with no or limited overshoot, global net anthropogenic carbon emissions need to decline by approximately 45% from 2010 levels and reach net zero around 2050. There also needs to be "*concurrent deep reductions in emissions of non-CO_2 forcers, particularly methane".*

The IPCC states that "*Such mitigation pathways are characterized by energy-demand reductions, decarbonization of electricity and other fuels, electrification of energy end use, deep reductions in agricultural emissions, and some form of CDR* [Carbon Dioxide Reduction] *with carbon storage on land or sequestration in geological reservoirs. Low energy demand and low demand for land- and GHG-intensive consumption goods facilitate limiting warming to as close as possible to 1.5°C*."[4]

It should be noted that the 2050 target for carbon neutrality assumes a 50% probability that average temperature rise is limited to 1.5°C.[5] For a 66% probability, carbon neutrality should be achieved in 20 years.[6]

2.5 There is little doubt that fossil fuel use needs to fall significantly. Energy suppliers, distributors, and companies and consumers need to shift demand to sustainable energy sources and deploy significant energy efficiency measures.

2.6 The flip side of reduced fossil fuel demand is lower production of fossil fuels. Both supply and demand sides need to align with a lower carbon world. On the supply side, fossil fuel companies should not act as if under 'business as usual' conditions. There are economic reasons why adjustment should be considered, linked to the probability of future tax and regulation regimes which increase the cost of fossil fuel consumption or production. There are also ethical reasons.

2.7 At the same time, it should be acknowledged that fossil fuels would continue to be produced even under a 1.5°C scenario, but at vastly lower levels than projections of no change. The use of oil for petrochemicals and plastics should also be noted. The life of oil reserves is limited, which is why attention should be paid to the future investment plans of fossil fuel companies.

2.8 At present, at the macro level, the pace of change in the extractives industry sector is well behind what is required. Some companies have reduced exposure to projects which may be particularly carbon intensive, in terms of Scopes 1, 2, or 3 emissions[7]. In some cases a shift towards gas and away from oil can be seen.

[4] IPCC, Chapter 2, Executive summary
[5] Equivalent to a carbon budget of 580 $GtCO_2$.
[6] Equivalent to a carbon budget of 420 $GtCO_2$.
[7] As defined by the GHG Protocol: Scope 1 emissions are direct emissions from owned or controlled sources; Scope 2 emissions are indirect emissions from the generation of purchased energy; Scope 3 emissions are all indirect emissions (not included in Scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

2.9 The private sector is a relatively small part of the picture. State oil and gas companies dominate oil and gas production, and are estimated to control approximately 70% of the world's oil and gas reserves; the reverse of the picture 40-50 years ago.[8] It is clear therefore that meaningful change in this sector has to happen at government level, with changes in the demand for fossil fuels from the private sector also being potentially highly influential.

3. Recent developments

The past year has seen the world gain a greater sense of the need to act urgently to combat global warming. Many countries have seen demonstrations calling for more action involving people of all ages. There appears to be increasing public support for action to address climate change, even if there is not always widespread agreement about which specific policies should be adopted. In response, governments have been speaking more often about the need to address climate change, though the policy response has lagged significantly.

The business sector has responded, with 2019 seeing a number of company announcements of new commitments, including zero emissions targets by specific dates. At its annual gathering in Davos this year, the World Economic Forum encouraged more action by business. In the financial sector, central banks and especially the Bank of England, have been looking at climate-related risks and pushing for change. Disclosure via Taskforce for Climate-related Financial Disclosures (TCFD) standards looks likely to become the norm. Concerned investors, not least the CFB, have increased their pressure for change.

Many fossil fuel companies have shifted their positions on the issue, in particular over the past few months. A number have made pledges to achieve net zero greenhouse gas emissions by 2050, including to varying extents Scope 3 emissions.

These shifts suggest there is the potential for further changes in 2020. Indeed, we appear to be nearing 'tipping point'. Should the cost of renewable energy continue to fall significantly over the next few years, or should nuclear fusion become viable, large scale economic changes are likely.

4. How existing CFB policies tackle climate change

The CFB, advised by JACEI, has been addressing the threat of climate change through its investment policies since 2002. In particular, it applies three policies which focus specifically on global warming. The aim is to manage portfolios which reflect the need to reduce carbon emissions and the ethical concerns linked to fossil fuels.

The three policies are:

- Climate change
  Inspired by the Methodist Conference Statement *Hope in God's* Future, the CFB commits to engaging with companies to reduce carbon emissions, and to managing portfolios with a carbon footprint which is lower than the market and declining.

- Electricity Generation
  The CFB focuses on the key source of carbon emissions. It commits to engaging with and even excluding companies with high carbon emissions intensity.

- Fuel types
  The CFB looks at the ethical issues linked to different fuel types, in particular fossil fuels. This leads it to take a hard line against coal producers. It also avoids investment in

[8] http://www.ipieca.org/news/20140612/ipieca-releases-fact-sheet-unburnable-carbon

companies solely or principally dedicated to finding new carbon assets, or with significant exposure to tar sands production.

These policies have led to a number of exclusions and divestments, including the mining company Glencore, a number of oil exploration and production companies, and two electricity generation companies. In addition, they drive ongoing engagement with companies, both suppliers of fossil fuels and those companies which are significant users.

The CFB has conducted a considerable amount of engagement with companies as it has applied these policies and taken account of further developments. Some engagement is conducted together with like-minded investors. The CFB has also co-filed and supported a number of shareholder resolutions addressing global warming in recent years. Further details are provided in Appendix 2.

5. Assessing fossil fuel companies

5.1 Determining the extent to which a fossil fuel company is aligned with the Paris Agreement is not straightforward. For a start, there is no consensus on what level of total fossil fuel production would be consistent with “well below 2°C”, though it should be well below the current level. How an individual company fits into projections for 2030, 2050, or even 2100 is impossible to determine. Nevertheless, we needed to form an opinion about the extent to which company behaviour today is consistent with those broad projections.

5.2 JACEI believes that a company’s reported investment plans are important but do not tell the whole story. In theory, it should be possible to determine which investments are within a ‘carbon budget’ consistent with a limit in global temperature rise. With the CFB, we examined attempts to do this but accurate estimates are not always available and the results only provide snapshots which do not take account of company commitments.

5.3 In addition, although time is running out, the timescales are such that it would be possible for a company to acquire new reserves and still claim it was committed to transition. Additional reserves with a life of ten years’ production could help meet fossil fuel demand for the next decade but could still be consistent with a global decline in production, either over the decade or afterwards, sufficient to limit total carbon emissions. The problem is that if every company acts like this, in aggregate fossil fuel production will exceed limits consistent with “well below 2°C”.

5.4 With the CFB, JACEI believes that the main drivers of change will come from:

- Shifts in the demand for fossil fuels, driven by consumer and citizen pressure
- Government action to change incentives and tax significant carbon use
- Technological developments in alternative energy and energy storage solutions
- Threats of legal action against producers and high emitters
- Pressure exerted by ethical and socially aware investors through shareholder engagement

While the financial considerations are outside the scope of this project, the increasing overlap between financial risks and ethical considerations is evident.

5.5 While fossil fuel companies can make significant changes to adjust towards transition and alignment with the Paris Agreement, it is impossible for an individual company to know how it can fit into the energy market in 2030 or 2050. If all private sector oil and gas companies ceased operations, supply would be further dominated by state oil companies; a fact which highlights the need for government action and for considerable transformation by companies which demand fossil fuels.

If all oil and gas companies began winding down, ceasing all capital expenditure other than for maintenance, they could potentially distribute large amounts of cash to shareholders but the lifespan of their existing reserves would not last long enough without further exploitation for transition to occur sensibly.

Humankind continues to demand energy from oil and gas which, unless compensatory action is taken, is not consistent with requiring suppliers of oil and gas to restrict production. In this environment, the more progressive oil and gas companies are trying to highlight, via Scope 3 estimates, how they fit into projections of global energy use.

5.6 An important challenge is the quality of emissions data. These data are likely to be highly variable, and projections provide only a guide, particularly since we are looking at long time spans. Scope 3 data are open to question and especially projections of Scope 3 emissions, given we live in a dynamic market economy. It is therefore appropriate to refer to the degree of certainty we have. Sometimes even this is not possible.

5.7 Basis for assessment

With JACEI's endorsement, the CFB identified five distinct categories within which to build a baseline assessment of fossil fuel companies as part of a methodology, which was endorsed by the 2018 Conference.

The CFB assessed companies across up to 25 metrics. For companies held in CFB Epworth portfolios it examined more closely and engaged with the companies where possible. A summary of the metrics will be available on the CFB website.

The five assessment categories are outlined below. Most weight is placed on the capital expenditure category.

- Asset mix

  The CFB looked at a company's current output from oil, gas, and coal and recent trends in the proportions in each. We look at the ratio of oil to gas in production and reserves. It also checked exposure to oil from tar sands. We wanted to see indications of a company moving in the right direction, towards lower emission fossil fuels. We have regarded gas as a viable transition fuel for these purposes.

- Capital expenditure

  A company's capital expenditure plans should be consistent with the Paris Agreement, but assessment is not straightforward. Nevertheless, we placed the greatest weight on this area.

  The CFB looked at company data, such as the proportion of revenue spent on exploration capital expenditure, the reserve replacement ratio (proportion of annual output being replaced by an increase in reserves), and the reserve production ratio (number of years' worth of production at current rates in a company's oil and gas reserves). It examined what companies said about their capital expenditure plans and also what Carbon Tracker had said about how consistent it believed capital expenditure projects were with a 2°C world. The CFB also rated a company for capital expenditure on low carbon/renewable energy production.

- Climate strategy and governance

  JACEI believes an assessment should go beyond only announced specific investment plans. It is important to look at the extent to which a company integrates climate change considerations into its strategy and governance.

  The CFB looked at mission statements, public announcements, risk assessments, links to executive remuneration, and lobbying activity. It examined CDP and Taskforce for Climate

Change-related Financial Disclosures (TCFD) disclosures. It also incorporated the assessment of company management by the Transition Pathway Initiative (TPI). It based its lobbying rating on ratings from InfluenceMap[9] but noted that some data were out of date because many companies have recently changed their lobbying policies.

- Positive transition steps
  The CFB looked for evidence that a company was open about plans to transition to a low carbon economy.

- Decreasing emissions[10]
  One way a company can demonstrate it takes global warming seriously is that it takes action to limit and reduce its own direct (Scope 1 and 2) emissions. Companies have recently been publishing Scope 3 emissions targets and ambitions.

  The CFB assessed these, with absolute targets preferred to relative, intensity-based measures. The CFB also incorporated the TPI carbon performance conclusions in a metric in this category. It looked for action to reduce flaring and signs of falling carbon intensity.

6. The assessment outcomes

6.1 The CFB analysed fifteen oil and gas companies and rated their performance against the categories described above, assigning them indicative ‘traffic lights’ to aid discussion.

6.2 Four companies, Exxon Mobil, EOG Resources, Conoco Phillips, and Hess, were rated red. All four are US companies, are focused more on oil production than gas, and did not rate well on capital expenditure metrics in particular. Exxon Mobil is the largest non-state oil company in the world. These companies appear to require significant transformation before we can be confident they will align with the Paris Agreement and it appears unlikely this will happen without government action. The CFB and Epworth did not hold these companies in their portfolios, and had already excluded Exxon Mobil on the basis of this work.

JACEI agreed with the CFB’s conclusion that these companies should be excluded from investment on ethical grounds.

6.3 Six companies were rated amber. These companies were Gazprom, Arc Resources, Chevron, Woodside, BP, and Total. Of these companies, Arc Resources, BP, and Total and were held in CFB Epworth funds.

An amber rating indicated that the assessment results were mixed and may have required further attention before drawing a conclusion. However, it would have required a significant revision of the result to conclude that amber rated companies were aligned with the Paris Agreement.

<u>ARC Resources</u>
ARC Resources was held in the Canada portfolio in the CFB Overseas Fund. It received poor ratings for capital expenditure and strategy and governance. With these outcomes and limited prospects for engagement with the company, JACEI advised that it should be excluded from investment on ethical grounds.

<u>BP</u>
BP’s production and reserve profile was focused towards oil rather than gas. Its spending on investment for the future appeared better balanced, though it did not rate relatively well for renewables capital expenditure. BP also measured relatively poorly on integrating climate

[9] https://influencemap.org
[10] This category title was changed from ‘Decreasing direct emissions’ to incorporate company commitments about Scope 3 emissions.

change into strategy and governance, as well as control of its own emissions. However, as this assessment was being completed, the new CEO announced a set of emissions targets out to 2050, which included some Scope 3 targets.

BP presents an interesting dilemma. It seems some way from being aligned yet reading recent company announcements it could become a contender for demonstrating a clear path to alignment. The new commitments are impressive and have a focus on absolute targets for Scope 3 emissions reductions, but so far there is no information about how they will be met. While it could well provide such information later in the year, for the purposes of this assessment, JACEI agreed with the CFB that it had not yet done enough and should be excluded on ethical grounds.

<u>Total</u>

Total has a progressive reputation because its Scope 3 ambitions have enabled analysts to make projections of future emissions. However, the information is not as detailed as that provided by Shell. Its oil focus may also be an issue at least in the short term and its performance in other respects was mixed. Despite the targets, JACEI judged that Total had not done enough to demonstrate alignment with the Paris Agreement, and it should be excluded on ethical grounds.

JACEI also advised the CFB that the other companies rated amber should be excluded on ethical grounds.

6.4 Five companies were rated green. These companies were Repsol, ENI, Royal Dutch Shell, Equinor, and OMV. Of these, all were held in CFB Epworth funds, with the exception of OMV.

A green rating indicated that across the metrics we examined, a company was one of those most likely to be aligned with the Paris Agreement, but that deeper examination was required. Even if JACEI's recommendation was that there was no current ethical bar to investment, we advised the CFB to continue ongoing engagement and assessment.

<u>Repsol</u>

Repsol assessed well in all categories, including with regard to emissions targets. It had published comprehensive targets, including most Scope 3 emissions, out to 2050. It planned to reduce absolute carbon emissions by 3m tonnes in 2025 vs 2018. It did have increasing Scope 1 and 2 emissions but these increases coincided with the acquisition of Talisman Energy in 2014. Carbon intensity had also been increasing. Repsol was the best-rated company on the metrics and had a progressive Scope 3 net zero target. It was more focused on gas than oil. The intermediate decarbonisation targets gave greater credibility to the overall ambition.

JACEI's recommendation was therefore that there was at present no ethical bar to investment. We advised the CFB that it should look for reductions in Scope 1 and 2 emissions, action to eliminate regular flaring by 2025, and a commitment to reduce oil production in the future.

<u>ENI</u>

ENI was the second highest rated oil company in our baseline assessment and it rated relatively well in the capital expenditure category. While noting the relatively positive rating we did have concerns about the level of public commitment; however, these were allayed to a significant extent by an emissions targets announcement. The announcement was about targets rather than ambitions, and was on an absolute rather than relative basis; both encouraging developments. ENI is the only company in the assessment apart from Shell to include in its targets all Scope 3 emissions including oil and gas bought from third parties. It also states that its oil and gas production will peak in 2025 before being reduced (especially oil). ENI believes that its methodology has a wider scope for measuring emissions than approaches used elsewhere in the industry.

JACEI’s recommendation therefore was that there was no current ethical bar to investment in ENI. We advised the CFB that it should look for: improved performance on Scope 1 and 2 emissions control; decreasing emphasis in executive remuneration calculations on the hydrocarbon business versus emissions reduction; a review of trade association membership; and delivery on commitments to increase the proportion of renewables in the energy mix.

<u>Royal Dutch Shell</u>
Shell rated relatively well across all five categories, including capital expenditure. Shell has been the most progressive super major globally. It has long recognised the threat of climate change, and its reporting of Scope 3 emissions and its publication of Scope 3 ‘ambitions’, has driven change in the industry. It has been open about the challenges given that world demand for energy is increasing. It is also very open to dialogue with investors, including the CFB, and others. Nevertheless, while we have had the impression that Shell had pledged specifically to be aligned with the Paris Agreement, this pledge has been hard to pin down in CFB discussions with Shell representatives, even though its Scope 3 emissions ambitions could be close to demonstrating alignment. Shell regards its Scope 3 projections as ambitions commensurate with society’s progress in transitioning. Given we are starting to see increased intensity of action by society, it could be argued that this commitment seems firmer than when it was first made. Shell’s *targets* for Scope 3 emissions run over five years, with reviews. The CFB expects Shell to try to retain leadership in responding to climate change but it might not be as nimble as some smaller or more focused companies.

JACEI believes that Shell should be encouraged to take further steps, including adopting absolute Scope 3 emissions targets rather than only carbon intensity targets. We advised the CFB that while there was no ethical bar to investment, we wanted to review the advice at our June 2020 meeting.

JACEI also advised the CFB that it should look for the following from Shell: a firm commitment to a net zero target; action to reduce further Scope 1 and 2 emissions with firm targets; positive lobbying for transition to a low carbon world; stronger links to global warming action and smaller focus on fossil fuel production in executive remuneration policies; and clarity on future spending on renewables.

<u>Equinor (formerly called Statoil)</u>
Equinor rated well across the categories. It does have an oil focus, though it told the CFB its focus is on lower carbon oil and gas. Equinor has recognised the threat of climate change and has been willing to work with investors to address their concerns. In 2019 it took steps with Climate Action 100+ investors to commit to some of the actions to which its peers are only now agreeing. From the Climate Action 100+ statement it appeared that 2020 could be an important year for this company. The commitment to renewable energy was particularly encouraging and we noted that Equinor was the only company assessed that had published its renewables pipeline. Despite the best rating with Shell in the ‘Decreasing emissions’ category, the Scope 3 targets are based on carbon intensity rather than absolute emissions.

JACEI advised the CFB that while there was no ethical bar to investment in Equinor, we wanted to review the advice at our June 2020 meeting.

JACEI also advised the CFB that it should look for the following from Equinor: continued reduction in capital expenditure on exploration as a proportion of revenue; absolute Scope 3 emissions targets; even higher capital expenditure on renewable energy; and further action on reducing its own Scope 1 and 2 emissions in line with its commitments.

6.5 Mining companies
The CFB also began assessment of two mining companies, BHP Billiton and Anglo American.

For a dedicated mining company such as Anglo American, there are fewer relevant metrics. BHP Billiton does have exposure to oil and gas. Both companies extract thermal coal.

Anglo American has committed to exiting completely from thermal coal production but has yet to say by when it will do so, noting that coal mining provides employment for large numbers of people in South Africa and so the exit process required conversations with, and decisions by, governments, communities, and individuals. It had produced a 56% reduction in thermal coal production since 2012. It believed it was aligned with the Paris Agreement. Anglo American has been the subject of CFB engagement on the basis of an existing climate change policy and JACEI advised the CFB that this should continue while more assessment is undertaken. BHP Billiton rated relatively well in the assessment but its exposure to thermal coal is a concern. JACEI also advised that further assessment and engagement should take place before we arrived at a firm opinion.

7. Consultations

The Reply to Memorial 32 (2017) notes the need for consultations with Methodist investing organisations. The CFB has kept Methodist organisations in touch with work arising from the Memorial and Reply throughout. The CFB's subsidiary, Epworth, also intends to launch a new Epworth fund which will seek to avoid investment in any fossil fuel company. This will be available for those Epworth clients who wish to see immediate disinvestment and the CFB will enable access to this fund for Methodist organisations. Modelling for this fund has satisfied the CFB that it could make the necessary changes on existing funds to accommodate exclusions in the oil and gas sector, while maintaining a similar risk profile. However, some work will be required, especially given recent market developments.

8. Resources

Work arising from this Memorial and Reply has required a high level of attention and commitment of time and resources by the CFB. It has been the main focus of ethical work over the past three years, during which time the CFB and Epworth launched a new range of funds, adjusted operations to new regulatory requirements, and, as this report was being completed, were managing funds as the coronavirus took hold while migrating the team to full working from home. Most of the content of this report was prepared by the CFB. JACEI records its thanks to the CFB team for its hard work and commitment in these most challenging times.

9. Conclusion

JACEI and the CFB have for many years worked to the same ethical basis as the Resolution, which is "*that if engagement with companies that are heavily dependent on the extraction of fossil fuels does not lead to business models compatible with the ambition of the Paris Agreement, disinvestment will ultimately be the response*."

It is clear that in 2030, or at least in 2050, fossil fuel production should be lower than current levels and a much lower proportion of global energy supply. We also note that in the transition phase fossil fuel output will be higher than required in 2030 or 2050. The actual output required depends on economic factors, innovation, and government action.

We have been looking for oil and gas companies to show they understand the threat to the planet and are prepared to change their business models accordingly. Some companies have made commitments that would not have been thought possible only a few years ago. Nevertheless, they need to show how they are compatible with the Paris Agreement, so they are part of the solution the world needs.

The CFB has assessed fifteen oil and gas companies, of which JACEI has recommended that ten should be excluded from investment on ethical grounds. These are:

- BP
- Total
- Chevron

- Arc Resources
- Gazprom
- Woodside
- Exxon Mobil
- EOG Resources
- Conoco Phillips
- Hess

Of the five remaining companies, JACEI has paid particular attention to the four held in CFB Epworth funds, namely Repsol, ENI, Royal Dutch Shell, and Equinor. These have all made commitments that lead us to believe they are aligned, or are close to being aligned, with the Paris Agreement. However JACEI advises the CFB that it should engage further with these companies to press for more detail on their commitments and for further action. We will review these companies at our June meeting, prior to the 2020 Conference.

The tragedy of the coronavirus pandemic has focused minds on that immediate threat to humankind. The required response has led to great uncertainty about our shared economic future. At the same time, the rapid and radical actions by governments show that it is possible to combat existential threats. Climate change is one such threat and we look for equivalent radical action by governments, companies, and investors.

JACEI commends this Report to the Conference.

*****RESOLUTIONS**

27/1. The Conference received the Report.

27/2. The Conference:

- **Welcomed the analysis provided by the Central Finance Board and JACEI, and the recent decision to disinvest from BP and Total**

- **Noted the recognition of the climate emergency by the 2019 Conference and the need for urgent action at all levels**

- **Noted that the Notice of Motion 2017/109 passed at the 2017 Conference requested disinvestment from any oil and gas company by the 2020 Conference that “has not aligned their business investment plans with the Paris Agreement target of a global temperature rise well below 2 degrees”**

- **Noted that the JACEI report for the 2020 Conference on Climate change and fossil fuels, which draws the conclusion that Repsol, ENI, Royal Dutch Shell, and Equinor "are aligned, or are close to being aligned, with the Paris Agreement", has not fully implemented Notice of Motion 2017/109**

- **Taking account of the findings of the Transition Pathway Initiative (TPI), a project supported by the Central Finance Board, referred to the Methodist Council a request that JACEI recommend that the Central Finance Board fully implements Notice of Motion 2017/209, and disinvests before the 2021 Conference from all oil and gas companies which are not currently aligned with the Paris Agreement target of a global temperature rise well below 2 degrees.**

Additional Agenda Item 27a. Climate Change And Fossil Fuels – Update Report

The Joint Advisory Committee on the Ethics of Investment (JACEI) work assessing oil and gas companies has continued in the past quarter. A regular JACEI meeting was held in June.

- JACEI members noted that the Central Finance Board had followed the Committee's advice and added several oil and gas companies to its ethical exclusion list. This had required the CFB to sell its holdings in BP, Total, and ARC Resources.

- JACEI reviewed a refreshed assessment of the oil and gas sector, focusing on four companies held in CFB funds, and including for reference BP and Total. New data from the Transition Pathway Initiative (TPI) was used for one of the metrics in the assessment. Rather than focus on one or two factors, companies are assessed across up to 25 metrics under five categories, as reported to Conference 2018: current asset mix; capital expenditure; strategy and governance; positive transition steps; decreasing emissions.

- JACEI noted that there had been no change in the green 'traffic light' rating derived for the four companies held in CFB funds.

- These companies have all made commitments that lead the Committee to believe they are aligned, or are close to being aligned, with the Paris Agreement. JACEI advised the CFB that it should engage further with these companies to press for more detail on their commitments and for further action.

- The CFB has committed to continuing its intensive engagement with fossil fuel companies, including on the points JACEI recommended, outlined in its Report to Conference, though the pandemic lockdown had prevented physical meetings from taking place. As a responsible shareholder, the CFB is committed to pushing for further and faster change.

    - **Repsol**
      Repsol had seen a small change due to the carbon performance metric now using TPI data, but the rating and its relative position was not affected.

    - **ENI**
      The ENI rating and relative position were unchanged.

    - **Royal Dutch Shell**
      After the assessment was completed in April, Shell made new announcements. It has a net zero target for Scope 1 and 2 emissions. It has a new ambition, to ensure its net carbon footprint is consistent with a +1.5°C outcome, rather than 2°C. It is the best company on the TPI data now being used for the carbon performance metric. We note that the current TPI analysis does not show that Shell is aligned with 1.5°C, but TPI states that "Its 1.5°C alignment claim could reflect the impact of its additional sectoral decarbonisation initiatives and plans to pivot over time towards serving the businesses and sectors that, by 2050, are net zero emissions themselves. However, these initiatives cannot currently be captured by TPI's Carbon Performance methodology."

      Shell has pledged to work "more closely with other organisations that are aiming for net zero by 2050, and potentially not serving those which do not share the same ambition". This links to an area we have advised the CFB to engage with the company about. The company had not yet appeared to have considered in detail how it would 'pivot' away from companies without a +1.5°C strategy. This is an area about which we have advised the CFB to engage.

      Overall, on the revised assessment, there was no change in the Shell rating and a slight improvement in its assessment. Its relative position remained unchanged.

- **Equinor**
  Equinor has seen marginal improvement since the March/April assessment due to its improving production and emissions trend. On the revised assessment, Equinor's rating remained unchanged, its assessment improved slightly, and its relative position remained unchanged.

- The Committee has not examined BP and Total in detail since issuing its advice in April, but it did note that Total had made new commitments regarding responding to global warming. Its advice has not changed.

The Climate Emergency is a matter of grave concern to Methodists. JACEI will continue to review the progress these companies make and should that reverse or prove insufficient it will update its advice to the CFB. JACEI will report further on this ongoing work to Conference 2021.

*****RESOLUTION**

27A/1. The Conference received the additional Report.

Appendix 1 – Conference Memorial 32 (2017) and subsequent Conference discussions

1.1 Memorial 32 (2017)[11]

The Memorial and Reply drew attention to past considerations of fossil fuel investment by Conference, the extensive engagement on climate change undertaken by the Central Finance Board (CFB), overseen by the Joint Advisory Committee on the Ethics of Investment (JACEI), including working in collaboration with other institutional investors, including the Church Investors Group. It also outlined the three policies on investment and climate change applied by the CFB, with the first in operation since 2009, noting that almost twenty companies had been excluded from investment as a result.

The Reply to the Memorial also noted that excluding all fossil fuel companies from UK equity investment would lead to total CFB ethical exclusions forming 27% of the UK equity market.

It was noted that "*Ethical choices need to be made in the context of the fiduciary responsibilities of the underlying Methodist investing organisations*" and that "*the removal of fossil fuel companies from a portfolio by a specific date raises questions of investment risk on which key stakeholders (such as pension fund trustees) would need to be consulted*."

The Conference noted that it "*affirms the ethical basis of this memorial, which is that if engagement with companies that are heavily dependent on the extraction of fossil fuels does not lead to business models compatible with the ambition of the Paris agreement, disinvestment will ultimately be the response*."

The Conference rejected the specific request for divestment because there was further work to be undertaken with respect to relevant ethical and investment questions.

The Conference, via the Methodist Council, requested that JACEI:

a) *examine the pace of change in the extractive industries sector;*

b) *in the light of the increasing urgency for more global action, continue actively to consider disinvestment criteria, timescales, and consultation processes required to disinvest from oil and gas companies that fail to comply with the ethical basis outlined above;*

c) *report to the Conference in 2018, with the expectation that any such company in which the Church invests has not aligned their business investment plans with the Paris Agreement target of a global temperature rise well below 2 degrees, there would be a recommendation that the Church disinvest from such a company by Conference 2020.*

1.2 Methodist Conference 2018

The 2018 Conference discussed and received a report from JACEI titled "*Climate change and fossil fuels: an update*". This report was requested by the 2017 Memorial and Reply.

The Report outlined the work to date undertaken by JACEI and the CFB in response to the 2017 Resolution. Various climate change scenarios had been reviewed. It was noted there was no consensus about what a "well below 2°C" world would look like. In particular, the scenarios produced by the IEA and the IRENA, with a 66% probability of a +2°C temperature rise, had proved illuminating.

The Report outlined the methodology for assessing fossil fuel companies that had been devised. Scenarios had been used to help understand what developments in energy

[11] The full text is available at https://www.methodist.org.uk/downloads/conf-2017-60-Memorials-to-the-Conference_post-Conference_Final.pdf

production would be required over time, so that company investment plans could be understood in this context. It was noted that "*in a dynamic market economy it is possible that some more efficient companies could be expanding production of fossil fuels even while the global level of production is falling, consistent with a "well below 2°C" scenario*."

The Report noted wider implications for the Methodist Church for energy efficiency and reduced reliance on gas for heating highlighted by the scenarios.

It also noted the following implications for JACEI and the CFB:

- Diversion of CFB resources at the expense of other activities and during an operations review and adjustment to new financial regulations.

- Required focus on the supply of fossil fuels, which meant it was unable to devote as much attention as it would have on companies with significant consumption of fossil fuels.

  The Conference received the Report and asked JACEI to report to the 2020 Conference on progress made implementing the methodology described.

1.3 Methodist Conference 2019

The 2019 Conference recognised declarations of a climate emergency by the UK government, Scottish Government, Welsh Government, and a number of local councils.

It stated that:
"*A climate emergency has been declared by the UK Government, the Scottish Government, the Welsh Government and a number of local councils. The intention behind such declarations is to increase the impetus needed to implement significant policy changes. Many Methodists have lobbied their MPs, and were invited to participate in a mass lobby of Parliament on 26 June 2019. Faced with a climate emergency, the Conference joins with Pope Francis and the Anglican Communion in endorsing the call for urgent action.*
It welcomes the declarations by the parliaments of the UK, Scotland and Wales and encourages members to pray, to reduce their own emissions, and to continue to ask MPs to support the robust policies needed to achieve net zero emissions."

Appendix 2 – Engaging for change

2. Climate change has been a focus of CFB ethical investment engagement for some time. A great deal of that engagement has been with companies in the oil and gas sector. In recent years there have been more opportunities to support and co-file shareholder resolutions and work with other institutional investors.

2.1 Shareholder resolutions

Shareholder resolutions are becoming a more popular way to express ethical concerns. Such is the magnitude of the global warming threat, and such is the slow progress made by companies, that investors are using resolutions to both increase pressure for change and increase the intensity of engagement.

The CFB voted to support a shareholder resolution at Royal Dutch Shell brought by ‘Follow This’, a Dutch NGO, at the 2018 AGM. The resolution called on Shell to set and publish targets for reducing carbon emissions aligned with the Paris Agreement, with such targets including Scope 1, 2 and 3 emissions. The resolution attracted 5.54% support, with Shell arguing its published Scope 3 emissions ambitions represented sufficient progress.

The CFB co-filed and voted for a shareholder resolution at BP’s AGM in 2019, calling on the company to explain how it will align with the Paris Agreement. The resolution secured the BP board’s backing and was passed with 99.47% of votes. The CFB also supported a resolution organised by ‘Follow This’ calling on BP to go further, including publishing Scope 3 emissions targets; unfortunately, this only secured the backing of 8.35% of investors.

The CFB supported a shareholder resolution at the BHP Billiton AGMs, calling for its membership of lobbying groups to better reflect the need to support transition to a low carbon economy. This followed the news that the company remained a member of the Minerals Council of Australia, which had spent significant sums on pro-coal lobbying and advertising. Despite opposition from the board, the resolution received 22% support at the UK AGM. The resolution was opposed by 72.9% of shareholders at the AGM in Australia.

The CFB worked with other institutional investors on a similar resolution for the Anglo American 2020 AGM; following dialogue, the company agreed to implement the changes for which we were calling, issuing a statement about its approach to trade associations.

2.2 Institutional Investor Group on Climate Change

The CFB is a founder member of the Institutional Investors Group on Climate Change (IIGCC)[12], which has over 200 investor members responsible for €30 trillion in assets, and has joined an IIGCC Paris Aligned Investment Initiative, focusing on listed equity and corporate bond assets. In 2018, the CFB supported an IIGCC-led campaign lobbying MEPs to adopt an ambitious approach to reducing car and van engine emissions including a target of at least 40% CO°2 emissions reduction by 2030. During Q4 2019, it signed an open letter to EU heads of states and governments to encourage them to support the net zero 2050 targets in the EU. The CFB was a signatory of an IIGCC letter to the G7 and G20 countries calling for renewed efforts to support ‘smart finance for smart buildings’ as a means of promoting energy efficiency.

2.3 Climate Action 100 +

The CFB is a member of Climate Action 100+[13], an investor initiative to push for action by the world’s largest corporate greenhouse gas emitters. Investors are engaging with the 100 ‘systemically important emitters’, which represent two thirds of annual global industrial emissions, together with 60 other companies which could drive the transition to clean energy. It is a co-lead engager with Anglo American, and a supporting investor with engagement with Equinor. In 2019, the CFB attended the Anglo American AGM, where it made a statement on

[12] https://www.iigcc.org
[13] http://www.climateaction100.org

behalf of the Climate 100+ investor coalition. This was part of an on-going dialogue being co-led by the CFB on Anglo American's transition to a low carbon economy. This involves biannual meetings with the company to raise issues related to climate change, including climate linked remuneration, Scope 3 emissions, and the reduction of coal mining. Equinor published a joint statement with investors in 2019.

2.4 Transition Pathway Initiative
The CFB is a founding member of TPI[14] and, until recently, sat on the steering committee. TPI assesses the management quality and carbon performance of companies exposed to the low carbon transition. In 2017, there was no data for the carbon performance for oil and gas, or mining companies. Now in 2020, there are oil and gas carbon performance data, and the mining data will hopefully be released soon.

2.5 Voting at company meetings
The CFB votes at company meetings according to a template it has constructed with the Church Investors Group. It has abstained on the report and accounts of CDP laggards (disclosure) in the FTSE 350 index, if the company was not assessed by the TPI. It will now vote against board Chairs where the company is not assessed by TPI as being at least 'level 2'. If Climate Action 100+ companies do not report on lobbying, the CFB will abstain on the report and accounts.

2.6 Church Investors Group
As active and significant members of the Church Investors Group (CIG) the CFB has promoted the climate change agenda. In June 2019 CIG focused a day conference on the subject and published a document outlining the different approaches taken by church investors[15]. In 2019, CIG engaged with companies with poor CDP ratings. Data shows that 47% of the 64 companies engaged with improved their response, including ten companies responding for the first time and seven which improved their performance by two or more grades. The CIG is planning to publish a statement calling for more action on climate change ahead of the United Nations Climate Change Conference (COP26) meeting.

[14] https://www.transitionpathwayinitiative.org
[15] https://churchinvestorsgroup.org.uk/wp-content/uploads/public/20190729-The-Climate-Crisis-and-Church-Investments-FINAL.pdf