

Really? ExxonMobil Left the Risk Out of its Climate Risk Report

Natasha Lamb and Bob Litterman | May 28, 2014

Imagine cycling down a sweeping mountain road when you hit a dense patch of fog. You know there's a hairpin turn ahead that runs across the lip of a dangerous cliff, but you don't know exactly how far ahead it is. When do you start braking? And how hard do you brake over time?

The answers seem so intuitive that the questions are hardly worth asking — you'd hit the brakes immediately, and hard — but these are the fundamental questions society must ask to address the risks posed by climate change.

Scientists have made clear that if we continue burning fossil fuels as we have, at some point we will face a dangerous cliff — a tipping point of rapid, irreversible change with catastrophic impacts. We just don't know when.

Our speeding bike already has pumped enough carbon dioxide into the atmosphere to far exceed the historical level of 280 parts per million, and we have surpassed 400 ppm at breakneck speed. When do we as a society hit the brakes?

If we know a cliff is ahead — and we do — but we don't know exactly where — and we don't — the logical response is to slam on the brakes hard enough to insure we can safely navigate the turn.

We believe society will do just that and, indeed, the process already has begun. Through some combination of market forces and regulatory intervention, we're confident that a "low-carbon" scenario will unfold in the not-too-distant future to appropriately reduce our dependence on fossil fuels.

In December, sustainable wealth manager Arjuna Capital and nonprofit **As You Sow** filed a shareholder proposal asking ExxonMobil how the firm would deal with such a scenario. The proposal didn't ask Exxon whether such a scenario was likely, only how the firm would deal with it should it come to pass.

It's a highly pertinent question for shareholders. Governments around the globe agree that global warming must be limited to no more than 2 degrees Celsius to avoid disaster. The best climate science tells us that to hit this mark, up to two-thirds of the fossil fuel reserves of energy companies must remain in the ground, unburned. And yet those reserves are valued on the companies' balance sheets at roughly \$27 trillion. What will those reserves be worth if they become "stranded" in the ground? Investors refer to this as "carbon asset risk."

This, it would seem, is one of the most pressing risks faced by energy companies in the 21st century. And one would think that assessing and planning for that risk would rank high among the priorities of any energy company management.

Last month, Exxon responded to Arjuna Capital's proposal by issuing a report on carbon asset risk in exchange for Arjuna's withdrawal of the shareholder proposal. The report, "Managing the Risks," forgot to address one thing: the risks.

Exxon asserted in the report that it is "confident" a low-carbon scenario won't come to pass, and that consequently, none of its hydrocarbon reserves will become stranded. The firm's argument was basically that policymakers won't in-



tervene in the face of unabated global energy demand.

But Arjuna's question wasn't whether a low-carbon future was likely. It was how the firm would deal with such a future possibility. It was a request for the most fundamental risk-management and scenario-planning exercise. Exxon's report said, in effect, we're certain that scenario won't happen so we don't need to plan for it.

But how can it be so certain?

Exxon's report does acknowledge the threat of climate change and accepts in a general way that we, as a society, should be braking rather than pedaling faster down the mountain. But the report argues that rather than braking harder and sooner to reduce climate risk, society should start cautiously and then make larger investments further into the future.

In its analysis of a low-carbon scenario, the report suggests that to hit the low-carbon target of a maximum of 450 ppm, society would need to spend around 2 percent of total income on emissions reduction today, with that figure ramping up to 44 percent of median income in 2090, or more than \$1,000 per ton of carbon dioxide in today's dollars.

One can only assume that this is its projected cost of a last-ditch effort to avoid catastrophe by pulling carbon directly out of the atmosphere at scale — that is, air capture and sequestration. This is indeed a rather strange forecast because most experts believe that air capture would cost less than that today, much less in 75 years.

Or perhaps it's just a scare tactic.

The company then argues that this low-carbon path is far too expensive to be feasible, and that we won't, in fact, spend such amounts. And because society won't bear these costs, a low-carbon future that strands Exxon's carbon assets isn't a realistic possibility. Q.E.D.

The report's ultimate advice: Shoot for 550 or 650 ppm and hope for the best. And at those levels, we can burn all our hydrocarbons.

Put differently: We're going to ignore this risk. It's safe for investors to do likewise.

Exxon is taking a myopic, indeed, willfully distorted view of climate and carbon-asset risk in order to minimize the extent to which investors accurately price it into Exxon's shares. The firm's "plan" is not a rational one for society, nor does it serve the long-term interests of its shareholders.

To us cyclists headed down the mountain in the fog, Exxon is saying, "Ignore the cliff. Don't worry about slowing down yet. It's a long way off. Let's go for it."

Our advice to shareholders: Beware investing in stranded assets. When climate risk is properly accounted for, their prices will fall.