Shareholder Resolutions at BP plc and Royal Dutch Shell plc

INVESTOR BRIEFING

March 2015

Introduction

This briefing provides investors with information regarding shareholder resolutions which will be on the 2015 AGM Agendas of BP plc and Royal Dutch Shell plc.

The 'supportive but stretching' resolutions call for increased disclosures of corporate strategy on climate change as part of routine reporting from 2016. These resolutions reflect the broader questioning of the outlook for fossil fuel companies in the context of the risks associated with climate change and are aimed at securing for investors sufficient information to make informed investment decisions.

In an unprecedented and welcome move, the boards of both companies have publicly recommended that shareholders support the resolutions. This is a turning point but investors still need to demonstrate their active support by voting in favour of these resolutions, not least to ensure that other fossil fuel companies receive a clear signal of evolving investor sentiment. It is also important that through ongoing active engagement with the companies, appropriate expectations continue to be set by investors during 2015 so that neither company can claim compliance with the resolutions while delivering inadequate information in 2016 (and beyond).

Background

The £160bn '*Aiming for A*' investor coalition has moved into the shareholder resolution phase of this capital stewardship initiative focusing on low carbon transition. The coalition, which includes the Local Authority Pension Fund Forum (LAPFF) and the largest members of the Church Investors Group (CIG), has been focusing on engaging with ten FTSE100 extractives and utilities companies, including asking questions at their AGMs since the autumn of 2013.

The 2015 resolutions reflect the need to balance the short- and longer-term aspects of shareholder value creation and investment risk concerns. The full co-filing group includes over 50 institutional investors[1] – including UK churches, charities, wealth managers and local authority pension funds, as well as a diverse group of overseas institutions from three continents. They were joined by over 40 clients of '*Aiming for A*' coalition member Rathbone Greenbank Investments, with individual supporters of ShareAction and the Ecumenical Council for Corporate Responsibility (ECCR) taking the total number of co-filers well above the necessary 100. Eight of the co-filing pension funds have assets in excess of $15bn: three AP Funds (Sweden), Connecticut (US), Ilmarinen (Finland), Greater Manchester (UK), West Midlands (UK) and West Yorkshire (UK). Co-filers ShareAction and ClientEarth assisted the coalition by coordinating the filing of the resolutions.

The *Aiming for A* initiative derives its name from encouraging the largest carbon emitters within the FTSE 100 to move towards an "A" rating in the CDP Climate Performance Leadership Index.[2] From their engagement to date, the coalition decided to focus the 2015 shareholder resolutions on areas which require the immediate attention of BP and Shell.

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BP plc	Royal Dutch Shell plc
Special resolution - strategic resilience for 2035 and beyond	**Special resolution - strategic resilience for 2035 and beyond**
That in order to address our interest in the longer term success of the Company, given the recognised risks and opportunities associated with climate change, we as shareholders of the Company direct that routine annual reporting from 2016 includes further information about: ongoing **operational emissions management**; **asset portfolio resilience** to the International Energy Agency's (IEA's) scenarios; **low-carbon energy research and development** (R&D) and investment strategies; relevant **strategic key performance indicators (KPIs) and executive incentives**; and **public policy positions** relating to climate change. This additional ongoing annual reporting could build on the disclosures already made to CDP (formerly the Carbon Disclosure Project) and/or those already made within the Company's Energy Outlook, Sustainability Review and Annual Report.	That in order to address our interest in the longer term success of the Company, given the recognised risks and opportunities associated with climate change, we as shareholders of the Company direct that routine annual reporting from 2016 includes further information about: ongoing **operational emissions management**; **asset portfolio resilience** to the International Energy Agency's (IEA's) scenarios; **low-carbon energy research and development** (R&D) and investment strategies; relevant **strategic key performance indicators (KPIs) and executive incentives**; and **public policy positions** relating to climate change. This additional ongoing annual reporting could build on the disclosures already made to CDP (formerly the Carbon Disclosure Project) and/or those already made within the Company's Scenarios, Sustainability Report and Annual Report.

Operational emissions management

In 2014, both BP and Shell achieved "B" carbon performance bands (on an A-E scale) through the CDP performance bands.[3] Within CDP's performance banding methodology, considerable weight is given to operational emissions management, alongside strategic and governance issues, like those in the sections below.

A key issue for these companies has been the lack of an overall operational emissions target. Shell achieved and then discontinued its CO2 reduction target in 2010. Since then, Shell has taken the position that an external target is no longer needed as it has internal targets and plans in place related to emissions reductions:

> *"Our voluntary target was part of the "thought leadership" role we played to lead our and others' (including regulators') actions on climate change. An external target is no longer needed as our own CO2 management is embedded and CO2 policies and regulations have now emerged in most countries."*[4]

Similarly, BP's 2014 CDP submission, states that:

> *"A company's GHG emissions can be influenced by a variety of factors that may result from shifts in business activity, production or assets. This makes it difficult to establish an appropriate company-wide GHG target that can be cascaded throughout the organization with the objective of achieving cost-effective emission reductions. For these reasons, BP – like many of our peers – does not set enterprise-wide GHG targets but instead requires performance management at a local level through our operating management system."*[5]

However, peers in their industry do make use of emissions targets; for example BG Group. Without external targets, it is unclear to investors how these companies are reducing risk and preparing for a carbon constrained future. In light of these issues, investors require more detail on how the companies are maintaining progress towards reaching an "A".

Asset portfolio resilience to post-2035 scenarios

BP and Shell both have a diverse portfolio of assets (operational and reserve). The role of gas as a transitional fuel is increasingly reflected in these portfolios. However, as reported by Carbon Tracker Initiative in 2014, neither BP nor Shell conduct comprehensive modelling of future oil demand in a 2°C-constrained world in line with the International Energy Agency's (IEA) scenarios. The companies' projections for 2035 oil demand are on average 36% higher than in the IEA's 450 Scenario.[6] The 450 scenario sets out an energy pathway consistent with the goal of limiting the global increase in temperature to 2°C by limiting concentration of greenhouse gases in the atmosphere to around 450 parts per million of CO2.

Shell has for many decades produced its own internal "Energy Scenarios". However, these scenarios merely consider what may happen in different assumed policy environments, but they do not consider the specific effect on the business. They are one of many inputs to strategic planning. BP states that it combines internal projections with a consideration of external scenarios and projections, including the IEA's main scenario. In BP's updated 'Energy Outlook 2035'[7], the main reference is to the IEA's 'New Policies Scenario' and 'Current Policies Scenario' which assume policies remain out of step with the 2°C target. This is a risky assumption since international climate negotiations could, as a result of public and other pressures, deliver binding targets that will impact on the industry over time. Regional and national public policies on carbon climate are already impacting the sector.[8]

To comply with the substance of the resolutions, BP and Shell should stress test their business models against all the IEA scenarios, and share the results openly with investors.

The specific asset portfolio areas that need to be addressed in 2016 reporting include:

- The definition of 'Asset portfolio' should include current exploration projects e.g. Shell's US offshore Arctic programme, in addition to current resources and proven reserves;
- The reporting should demonstrate a full consideration of the business impact of the IEA 450 scenario rather than the scenario being ignored;
- The reporting should address the specific elements of the IEA 450 scenario, including if and how it sees the company differing from general trends;
- Routine reporting should include disclosure of break-even oil prices for individual projects. This is essential to understand the resilience of the asset portfolio to different demand/price scenarios;
- Reporting should provide more detail from Shell and BP on the integration of assumed carbon pricing into their modelling;
- Reporting on the other IEA scenarios should include an analysis of the physical and macro-economic impacts of climate change on demand.

Low carbon energy R&D and investment strategies

In the context of a transition to a low carbon world, investors would like BP and Shell to disclose the steps they are taking with respect to research and development (R&D) in this area. Adequate disclosures of these initiatives would allow investors to make informed decisions with respect to the long term strategies of the companies.

Shell is building biofuel capacity through a joint venture with Brazilian firm Cosan[9] and has a flagship carbon capture and storage (CCS) project in Canada[10]. Shell promotes CCS as relevant for the long term viability of the business. However, recent research including that conducted by Professor Paul Ekins, director of the Institute for Sustainable Resources, University College London, and Dr Christophe McGlade, research associate in energy modelling, has questioned the effectiveness of CCS roll out for fossil fuels as a means of dealing with climate change[11]. Investors therefore need to know Shell's post 2015 plans for low carbon energy including the budget allocated to this area, from R&D through to investments that could achieve commercial scale.

BP has an Alternative Energy[12] business and has invested $8.3bn in renewable technologies between 2005 and 2013, but questions have been raised about the corporate commitment to this strategy, in particular their lack of targets for further investment[13]. 20% of BP's R&D is already directed towards low carbon transition but investors would like BP's 2016 disclosures to provide more detail on BP's post 2015 plans in these areas and of any plans to raise the percentage of the company's total R&D spend on low carbon transition.

Strategic key performance indicators (KPIs) and executive incentives

Transitions that span decades are complex to manage and often require lead indicators and incentives appropriate to the timescales involved.

BP indicate that they already provide incentives internally for the management of climate change issues. These cover energy efficiency, emissions management and R&D among others. BP's CEO Bob Dudley's focus on 'value not volume' is welcome. Shell's CEO, Ben van Beurden has also emphasised the importance of capital discipline[14] and Shell includes sustainability factors in the annual employee bonus.

However, investors have an interest in the disclosure of BP and Shell's evolving approach

> *"Climate change is a major business risk. BP and Shell hold our financial and environmental future in their hands. They must do more to face the risks of climate change. Investors can help them by voting for these shareholder resolutions."*
>
> - James Thornton, Chief Executive Officer, ClientEarth[15]

to KPIs and executive incentives, in order to be able to assess board level commitment to the companies' evolving roles in the transition to a low carbon economy.

In the future, incentives will need to reflect a corporate transformation or managed decline strategy. Investors would like to see performance targets that incorporate a greater emphasis on safety and the environment, reward above average performance, and include a lesser importance on elements that are inconsistent with low carbon transition such as Reserve Replacement.

Public policy interventions

As with peers in the sector, both companies invest considerable time and resources influencing public policy, and it is not always clear to investors whether stated support for a low carbon transition is matched by this public policy work. Investors are interested in instances where BP and Shell may have intervened in public policy to the detriment of effective climate change policy.

BP has co-ordinated its approach to public policy at the group level since 2011 and recently joined over 70 countries and over 1000 companies in signing the World Bank statement for a price on carbon.[16]

However, BP's CDP submission states that one of its performance indicators is:

> *"Effective advocacy to influence policy makers and regulators to develop and implement measures to address climate change that avoids disproportionate impact on BP and thus protect shareholder value."*[17]

It is unclear what is meant by disproportionate impact. In addition, concerns have been raised recently about the influence of multi nationals and trade associations on government climate policy in the European Union (EU), USA[18] and elsewhere. Investors are reassured that BP left the Climate Action Partnership[19] but require greater transparency with regards to other aspects of BP's public policy programme.

Shell is a member of the Prince of Wales Corporate Leaders Group and has signed their Climate Change statements, including the recent Trillion Tonne Communiqué.[20] However, investors would benefit from more routine disclosures of Shell's public policy programme, including positions on relevant policy measures, especially for the crucial 2015 to 2020 policy making period. The same concerns about the influence of multi nationals and trade associations on government climate policy in the European Union (EU), USA and elsewhere also apply.

Robust public policy disclosures should include the following areas:

• Total lobbying expenditure on climate related issues, including direct and indirect spending via trade associations;
• Disclosure of all trade association memberships;
• Disclosure of management oversight intended to ensure consistency between company position and trade association initiatives.

Conclusion

By supporting the resolutions, investors can engage effectively with BP and Shell about the key climate issues affecting these major industry players and in so doing, send an important signal to other fossil fuel companies.

More information on the Global Investor Coalition on Climate Change's document outlining their expectations for oil & gas majors is available from: http://globalinvestorcoalition.org/. This builds on their carbon asset risk (CAR) initiative.[21]

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ShareAction (Fairshare Educational Foundation) is a registered charity that promotes responsible investment practices by pension providers and fund managers. ShareAction believes that responsible investment helps to safeguard investments as well as securing environmental and social benefits.

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