

WORKING DRAFT
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Working Principles for Investment in Fossil Fuels



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The Challenge of Investing for Net Zero

Human-induced climate change presents profound challenges to all forms of economic activity. The fossil fuel divestment movement has been hugely successful in drawing attention to the role of asset owners and asset managers in either perpetuating the status quo or facilitating the transition to a net zero carbon economy. It raises important strategic, instrumental and ethical questions about the investor's role. Divestment can send a powerful moral message and create space for political action. Many asset owners are, however, deciding to remain engaged with at least part of the extractive fossil fuel sector, including leading universities such as Oxford and Harvard.

Climate impacts are primarily determined by cumulative carbon dioxide emissions emitted into the atmosphere over all time. Hence, in order to stabilise global temperatures, net global emissions must be reduced, in effect, to zero. In a net-zero world, for every tonne of carbon dioxide released, a tonne must be permanently removed from the atmosphere. Meanwhile, the demand for affordable energy services, an essential ingredient in alleviating global poverty, is expected to increase several-fold over the 21st century. Meeting this demand while minimising committed cumulative carbon dioxide emissions will require significant further development of existing zero-carbon energy systems as well as the creation and deployment of new zero-carbon and carbon-negative technologies. A crucial test of any investment strategy is whether it drives or hinders these developments.

A challenge for divestment movements is that fossil fuel companies and related industries will likely play an important role in the transition, and shareholders' capital, license and encouragement will determine the nature of that role. Some uses of fossil carbon, such as air transport and shipping, currently have no substitutes and the involvement of the hydrocarbon industry is likely to be essential to rapid development of synthetic alternatives. Should large-scale carbon dioxide disposal eventually be required to stabilise climate, many of the skills and expertise required may be found or developed within the oil, gas and fossil fuel utility sectors. Progress on all these fronts has, however, been painfully slow over the last few decades; yet investors who remain engaged with the fossil fuel sector clearly have an interest in accelerating these developments to minimise the risk of asset stranding while playing their part in meeting climate goals.

Active engagement by institutional investors has so far been relatively uncoordinated, hampered by lack of clarity about what investors can and should be asking the firms to do, particularly those whose core business is fossil fuel extraction. When assessing divestment decisions, the following questions, building upon the latest understanding of climate science and energy system transitions, can help inform climate-conscious investors in setting their terms of engagement with the fossil fuel industry.

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The following questions provide a suggested framework for engagement between climate-conscious investors and companies with significant activities in the extractive fossil fuel sector and carbon intensive industries. Building upon the science of long-term climate change, they focus on how investments contribute to the global stock of cumulative carbon dioxide emissions, complementing other measures, such as carbon footprinting, that focus on emission flows.

1. **Science: Does the company accept the science that climate stabilisation (at any temperature increase) requires net zero carbon dioxide emissions?**

Net global emissions of carbon dioxide must reach zero to stabilise global temperatures, whether at +2 °C, +3 °C or any other level. More specifically: at what global temperature increase above pre-industrial levels does the company plan for their operations, supply chain and the products they sell to be consistent with net zero emissions? Has the company published or are they developing a net zero transition plan? If the company envisages a substantial role for offsetting of residual emissions, what is the offset mechanism, is it reliable and available at sufficient scale for a global transition, and who is going to pay for it? Are the company's public statements and support for other organisations and lobby groups consistent with advancing public, political and corporate action for net zero emissions?

2. **Strategy: During the transition to net zero, does the company have a strategy to limit future committed cumulative carbon dioxide emissions?**

Limiting future warming requires limiting cumulative carbon dioxide emissions. Does the company's capital investment strategy increase or decrease committed future emissions? In the case of an extractive fossil fuel company, what is the balance between investment in exploration or acquisition of new fossil carbon reserves versus investment in carbon dioxide disposal? For companies that provide a carbon-intensive service or fuel for which there is no currently available substitute, how are they contributing to the development and deployment of substitutes or remediation measures? For products and services for which zero-carbon substitutes already exist, what is the strategy and timescale for adopting them? If carbon dioxide removal plays a substantial role in the company's plans, how will it be achieved, paid for, monitored and maintained – in effect, permanently?

3. **Milestones and Metrics: Has the company provided milestones and metrics to allow investors to monitor their progress in implementing their transition plan?**

Abrupt and unanticipated transitions incur the greatest risks of systemic instability and asset stranding. If a company has a plan for a progressive transition to net zero emissions, how will investors monitor their progress to ensure it is consistent with minimising risks to future climate and risks to future asset owners, consumers and taxpayers? While most companies choose to measure progress over time, metrics indexed to the observed accumulation of carbon dioxide in the atmosphere or to the level of human-induced warming offer a more scientifically-grounded way to gauge both ambition and progress. A plan to reduce a company's emissions by 30% by 2030, for example, must be part of a strategy to achieve net zero emissions by the time global temperatures reach 2 °C, if that is the long-term goal.

If the answer to all three of these headline questions is positive, and supported by a convincing narrative strategy, then investors have a case for remaining engaged with that company and providing capital to support their transition.

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The Oxford Martin School, in collaboration with the Stranded Assets Programme of the University's Smith School of Enterprise and the Environment, the Environmental Change Institute, other colleagues in Oxford, Harvard, Columbia and other universities and the 2^o Investing Initiative, is consulting with a range of stakeholders, including asset owners, asset managers, the fossil fuel industry and the academic and non-governmental communities, to devise constructive terms of engagement between investors and the fossil fuel industry. This aims to allow both investors and the industry to play their part in safeguarding future climate.



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