Institute for Energy Economics and Financial Analysis
IEEFA.org

River's Edge
3430 Rocky River Drive
Cleveland, OH 44111
216-688-3433
staff@ieefa.org

# ExxonMobil's Climate Risk Report: Defective and Unresponsive

**By Kathy Hipple and Tom Sanzillo**

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ExxonMobil shareholders[1] have waited for over 25 years[2] for the company to articulate climate-change financial risks to its business. In the face of changes driven by technological advances and global climate change agreements, ExxonMobil shareholders have filed resolutions requesting disclosure reports on the impact of these changes on the company's reserves and resources, and the associated financial risks.

In 2017, ExxonMobil agreed to publish the second of two company climate risk reports. The "2018 Energy and Carbon Summary," which was released in February 2018 and is the subject of this memo, is defective and unresponsive to the shareholder resolution that prompted it. Shareholders should react with "no" votes on one or all of the company's proposed board of directors.

Some background: In 2014, after two years of shareholder proposals asking ExxonMobil to assess its carbon asset risk, the company released its first carbon asset risk report.[3] In that report, ExxonMobil concluded that climate change posed no risk to the company, relying in great part on its projection of increasing demand for energy in developing nations. In 2016, shareholders once again asked ExxonMobil to evaluate its carbon risk following the adoption of the Paris Agreement, signed by the vast majority of national governments, to limit warming to significantly less than 2 degrees Celsius above pre-industrial levels.

Shareholder resolutions filed in 2016 and 2017 specifically requested a disclosure report assessing the impact of a 2-degree scenario on the company's reserves and resources—and the financial risk associated with such a scenario. Thirty-eight percent of ExxonMobil's shareholders voted in favor of the shareholder resolution at the company's 2016 annual board meeting. The following year, major proxy advisors Institutional Shareholder Services (ISS) and Glass Lewis both encouraged shareholders to support the resolution, and 62% voted

[1] http://www.apnewsarchive.com/1990/Exxon-Shareholders-Overwhelmingly-Reject-Environmental-Proposals/id-fc58470d6e81ead01f89be50a6c772c7
[2] http://books.insideclimatenews.org/exxons25years
[3] In March 2014, in response to shareholders by *As You Sow* and Arjuna Capital, ExxonMobil issued the first climate asset risk report called "Energy and Carbon -- Managing the Risk," http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/report---energy-and-carbon---managing-the-risks.pdf

for it. Yet ExxonMobil still would not agree to publish a report. It was only after the New York State Common Retirement Fund re-filed the resolution for a third consecutive year (filed in 2017 for the 2018 shareholder meeting) that ExxonMobil agreed, in December 2017, to publish a climate risk report. The New York State Common Retirement Fund then withdrew the resolution.

ExxonMobil's 2018 Energy and Carbon Summary, like its previous report, dismisses potential carbon impacts as unlikely, concluding that, even if demand falls or regulatory restrictions are enacted, neither will pose a material risk either to ExxonMobil's reserve calculations or to its financial risk profile. The company therefore assumes a business-as-usual operational strategy, which includes increasing capital expenditures to expand drilling operations in the U.S. and abroad. Throughout the report, the company acknowledges climate risk. It acknowledges no role in having created this risk, however, and further assumes no significant leadership role in mitigating this risk.

Shareholders, who assume that the global agreement to maintain global warming to less than 2 degrees Celsius might cause a reconsideration of ExxonMobil's earlier conclusions of no risk, have every right to be critical of the substantive content of the report. And many of them, including the New York State Common Retirement Fund, have cited deficiencies in Exxon's approach.[4] After thanking the company for its report, a representative of the New York fund said the report was overly general, relied on overly optimistic assumptions, and failed to provide detail on emissions.[5]

While ExxonMobil may deny risks to its business, the market appears to be negatively pricing the cumulative set of risks facing the company, including climate risk. Since March 2016, when the SEC sided with shareholder requests to be allowed to vote to request a climate risk report, Exxon's stock has dropped 11% while the Standard & Poor's 500 Index has risen 32%.

The 2-degree scenario represents a policy consensus achieved at the 2015 United Nations Climate Change Conference. Investment strategies taken by countries and energy companies are gauged for consistency with progress toward this objective. While ExxonMobil acknowledges this consensus, [6] it continues a 20-year pattern of obfuscating these goals.

The shareholder resolution filed by the New York State Common Retirement Fund in 2017 was clear and specific:

> RESOLVED: Shareholders request that, beginning in 2018, ExxonMobil publish an annual assessment of the long-term portfolio impacts of technological advances and global climate change policies, at reasonable cost and omitting proprietary information. The assessment can be incorporated into existing reporting and should analyze the impacts on ExxonMobil's oil and gas reserves and resources under a scenario in which reduction in demand results from carbon restrictions and related rules of commitments adopted by governments consistent with the globally agreed upon 2-degree target. This reporting should assess the resilience of the company's full portfolio of reserves

[4] https://www.ceres.org/news-center/press-releases/new-exxon-report-step-forward-investor-disclosure-climate-change-falls

[5] Ibid.

[6] http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/2018-energy-andd-carbon-summary.pdf, p. 5.

and resources through 2040 and beyond, and address the financial risks associated with such a scenario.[7]

ExxonMobil's 2018 Energy and Carbon report, however, is vague and general. It is fundamentally unresponsive to the resolution, which outweighs any minimal furtherance of disclosures to its shareholders. One need not agree or disagree with the company's outlook to come to the conclusion that the report is deficient.

The following questions speak to how the report fails to adequately address the shareholder resolution.

## Does the report address a 2-degree scenario?

No. The company concludes that under current plans and conditions, and after the deployment of every conceivable technology currently known,[8] the 2-degree scenario is unlikely ever to be achieved.[9] Significantly, the shareholder resolution did not ask the company for its opinion about the likelihood of a 2-degree scenario coming to pass. It asked for a thorough look at the impact of the 2-degree scenario on the company's reserves and resources, along with associated financial risks. The report is fundamentally unresponsive to the resolution because it does not assess a 2-degree scenario and only assesses how the company would fare in a world with very few carbon restrictions.

ExxonMobil details its understanding of the 2-degree scenario in this report,[10] but the details stop when the company turns to a discussion of its reserves. The company concludes that even if the 2-degree scenario were adopted, it would pose no risk to the company's reserve calculations or financial risk profile.[11] ExxonMobil provides little detail on its proven reserves (20 billion oil-equivalent barrels), and even less on its unproven reserves (71 billion oil-equivalent barrels). ExxonMobil states that nearly all of its current 91 billion barrels[12] of oil-equivalent reserves (both proven and unproven) can be extracted and sold based on the company's current market and operational assumptions.

## Does the report address potential global climate change policies?

No. The report largely dismisses the possibility of global climate change policies, stating that "many uncertainties exist concerning the future of energy demand and supply, including potential actions that society may take to address the risks of climate."[13] It concludes that "due to the complexity and scale of the world's energy system and its interaction with societal aspirations, no single pathway to 2°C can be reasonably predicted." The company

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7 https://www.osc.state.ny.us/press/docs/exxon-mobil-corporation-shareholder-proposal.pdf

8 http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/2018-energy-and-carbon-summary.pdf, p. 6.

9 The closest the company comes to offering an outlook is to state that its Energy Outlook believes a 2.4 degree standard is achievable under conditions of maximum efficiency. http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/2018-energy-and-carbon-summary.pdf, p.6. It is unclear throughout the study what emission results will occur from ExxonMobil's business as usual and what temperature outcomes are likely from it.

10 Ibid.

11 Ibid.

12 Ibid., footnote 19, p. 25.

13 Ibid., p. 6.

was not asked for its opinion about the likelihood of climate change policies being enacted, or which pathway would successfully limit global warming to less than 2 degrees. ExxonMobil was asked for the potential *impact* of such policies on the company's reserves and resources and for an assessment associated financial risks.

Given ExxonMobil's extensive lobbying efforts on many issues, including climate change, which have also been the subject of numerous separate shareholder resolutions, the report's reticence on potential policies appears to be deliberately unresponsive. The report is limited to vague statements that the company will continue to engage on climate policy.[14] As a founding member[15] of the Climate Leadership Council, which supports a carbon tax,[16] the company surely has exposure to detailed analysis of potential legislative actions that might impact its business. Yet the report does not address the benefits and costs to the company that would be created by important policy changes that ExxonMobil appears to support.

## Does the report provide a sufficient analysis of financial risk?

No. The report is unresponsive to the financial risk request by the shareholders for the following reasons.

**1**. It does not put the climate issue into a financial risk context. The resolution asks for the report to "address the financial risks associated with such a scenario." The company acknowledges in several places the complicated set of financial factors that weigh on company investment strategy. Energy modeling,[17] proven and probable reserve calculations,[18] production modeling[19] and carrying value for property plant and equipment are all subject to a host of ever-changing market-driven inputs.[20] In other financial filings ExxonMobil articulates a broader set of financial risks facing the company.[21]

In this report, however, the company rejects the proposition that climate constraints pose any financial risk, now or in the future. It offers no information or analysis on the broader question of where climate constraints fit into the overall financial risk profile of the company.

**2**. Had the company discussed the current level of baseline financial risks it faces and then layered in carbon restrictions, its conclusion might be different.

ExxonMobil is in financial distress. The company has handled its capital expenditures poorly over the past decade. In 2016, ExxonMobil wrote off more than four billion barrels of reserves in the Canadian tar sands. This amounted to 19% of the company's worldwide reserves. It

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[14] Ibid., p. 2

[15] https://www.clcouncil.org/founding-members/

[16] https://www.clcouncil.org/our-plan/

[17] http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/2018-energy-and-carbon-summary.pdf, p. 7-8.

[18] Ibid., p. 9-11.

[19] Ibid., footnote 24, p. 25.

[20] Ibid., footnote 26, p. 25.

[21] ExxonMobil's 2016 10K lists a series of economic, demand and supply, market, policy, legal, regulatory, political and other risks. https://www.sec.gov/Archives/edgar/data/34088/000003408817000017/xom10k2016.htm. Climate related risks do not take place in a vacuum. To analyze them in a vacuum does not provide investors with a full and complete picture of the gravity of the actual financial risk individually and as part of the cumulative risk profile faced by the company.

was a write-down of a full decade of acquisitions in Canada that wrongly assumed ever-increasing oil demand at ever-rising prices.[22]

The company also acknowledged a mistake[23] in overpaying for the reserves secured in a $6 billion acquisition of XTO natural gas assets.[24] The company has written down natural gas assets in 2016, and again in 2017. It recently acknowledged it would not be going forward with certain investments in the Russian North Sea.[25]

In the wake of this long list of failed investments, and the weakness in financial performance of its upstream operation,[26] the company has not acknowledged problems with its upstream operations nor for the past several years has it announced any remediation efforts. To the contrary, it has announced a new round of upstream investments at higher capex levels,[27] a move that is being met skeptically on Wall Street.[28]

**3**. Over the past five years, the Standard and Poor's 500 Index has risen by 82% and ExxonMobil's stock has dropped by 15%. ExxonMobil once led the world's stock market. Today it lags. The stock price represents a summary judgment by the market on the company's diminished profitability, its current performance, and it is outlook. Recently the company announced that it missed its 2017 earnings target—even after its realized price of oil rose by 28%. Over the longer term, the company is projecting a low oil price environment at least through 2022.

**4**. The company has claimed that it is uniquely positioned to weather its financial distress and that of its industry peers. However, this claim of superiority regarding its accounting systems and reserve valuations has itself become the source of investor concern.[29] In 2015-2016, most oil and gas concerns wrote down the value of their assets. One estimate placed the value destruction at $230 billion.[30] ExxonMobil, unlike its counterparts, did not write down its assets, insisting to the *Wall Street Journal*[31] that its internal system of accounting was superior to other companies. The SEC is investigating. Two state attorneys general have raised similar concerns about how the company accounts for its assets.[32]

The 2018 report bases most of its reserve and financial risk claims on the integrity of its system of proven and probable resources. These are the same systems now under scrutiny. The scrutiny of its reserve calculations emanates from challenges made by outside regulators and law enforcement on ExxonMobil's climate disclosures. How can the company offer no extended treatment or discussion of its reserve valuations and financial risk portfolio when the SEC and attorney generals are investigating how the company values these reserves?

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[22] https://www.bloomberg.com/gadfly/articles/2017-02-24/exxon-mobil-losing-reserves-is-a-chance-to-reset

[23] https://breakingenergy.com/2013/05/30/timing-was-off-for-xto-deal-says-exxon-ceo/

[24] https://www.reuters.com/article/us-xto-exxon/exxon-mobil-to-buy-xto-energy-in-big-u-s-gas-bet-idUSTRE5BD28G20091214

[25] https://www.nytimes.com/2018/02/28/business/energy-environment/exxon-russia.html

[26] https://www.bloomberg.com/gadfly/articles/2018-02-02/exxon-mobil-earnings-oil-giant-picks-sour-note-to-trumpet

[27] https://seekingalpha.com/article/4142830-exxon-mobil-xom-q4-2017-results-earnings-call-transcript, See question from Doug Terreson, Analyst, Evercore ISI.

[28] https://www.reuters.com/article/us-exxon-mobil-meeting/exxon-tries-to-sell-wall-street-on-growth-plan-but-shares-drop-idUSKCN1GJ1TP

[29] https://www.cnbc.com/2016/09/20/sec-investigating-exxon-mobil-on-climate-change-accounting-practices-report.html

[30] Evaluate Energy, 2015-2016 Oil and Gas Impairments, (Proprietary Document)

[31] https://www.wsj.com/articles/exxons-accounting-practices-are-investigated-1474018381

[32] https://www.wsj.com/articles/sec-investigating-exxon-on-valuing-of-assets-accounting-practices-1474393593

At best, the report is unresponsive on the issue of financial risk.

## Does the report adequately analyze the potential impact on ExxonMobil's reserves in a 2-degree scenario?

No. The shareholders who brought the resolution are seeking greater transparency and disclosure on climate risk. The ExxonMobil report thwarts this objective by providing an incomplete quantitative picture of the company's reserves and resources under a 2-degree scenario. The company provides minimal data concerning its reserves, and even less on its resources. Absent greater context and clarification, the data offers an inconclusive picture of the company's proven and unproven. This failure to provide greater detail on its reserves undermines the conclusion that the 2-degree scenario poses no risk.

The ExxonMobil report states that the company has 91 billion in proven (20 billion) and unproven (71 billion) oil-equivalent barrels in reserve.[33] According to the document, the company plans to replenish 35 billion of oil-equivalent[34] barrels by 2040 at a time when oil demand is likely to decline under the 2-degree scenario. The company assumes current levels of production and the need for the continuation of its policy of 100% replacement reserve.[35] The company asserts that even its unproven resources are extractable under a wide range of unspecified scenarios. The report suggests the size and diversity of these undeveloped resources will allow the company "considerable flexibility to profitably develop new supplies."[36]

Exxon's explanation raises many additional technical issues and policy questions. For example, how does the company project its 2016 baseline production levels out through 2040? What assumptions are built into its projections? What are the technical standards that ExxonMobil applies to bring unproven reserves into the proven reserve category? On a policy level, why does the company support more acquisitions between now and 2040 in order to replenish 35 billion barrels of reserves off its current base of 91 billion barrels? Why must it continue to adhere to 100% replacement reserves in a time when the rate, if not actual oil demand in the aggregate, is likely to decline?

Investors want a specific empirical understanding of the company's production assumptions, annual use assumptions, current and projected acquisitions and other additions to the proven reserve category, and various economic and financial projections. Absent placing ExxonMobil's physical and financial reserve calculations in this specific context, the report provides no basis for the company's conclusion that its reserves and resources are unaffected by carbon constraints.

To test the company's conclusions, investors also need a listing of all its individual assets, values, production estimates and assumptions, and a production calendar of both proven

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33 http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/2018-energy-and-carbon-summary.pdf, The 20 billion proven and 71 unproven are placed in the report on two separate pages. The numbers are combined by ExxonMobil I footnote 9, p. 25.

34 Ibid., p. 11.

35 Ibid., footnote 24, p. 25.

36 Ibid., p. 11.

and unproven reserves.[37] Absent such specificity it is difficult to test the validity of the company's claims regarding its reserves.

ExxonMobil acknowledges the current market transition to an energy mix of lower carbon-intensive fuels. As this transition proceeds, it is no longer acceptable for the company to expect shareholders to accept summary statements about valuations, especially when the company's current financial reporting is under scrutiny and the company's recent financial performance raises so many red flags. The current investment climate requires that ExxonMobil carefully weigh its historic claims to proprietary secrecy against the need for greater transparency, in order to shore up investor confidence in the quality of the company's stock offering.

## Does the report go beyond 2040, as requested?

No. The report provides analysis only through 2040, even though ExxonMobil no doubt has ample scenario analyses that extend decades into the future. ExxonMobil indicates global trends that include economic and population growth through mid-century will affect demand for its product and that industry-specific factors such as decay of production will affect its reserves. The company asserts that it needs acquisitions and capex with investment horizons of decades to meet demand and, according to the report, replace reserves. Nonetheless, the report offers a view that goes only through the next 22 years. Shareholders, many with internal mandates to consider the long-term balance of assets and liabilities, would benefit from the company's longer-term perspective on climate risks to its business.

## CONCLUSION

ExxonMobil has been aware of the climate change issue for decades. The company report in question here is on just that topic. However, the company's disclosures regarding climate change have come only as a result of outside pressure and external reporting. This report, issued at the request of 62% of shareholders, is no different from previous company statements.

This report's findings and conclusions are grudgingly given, and the overall dismissal of any risk to reserve valuations and financial risk is also consistent with ExxonMobil's strategy to assert its superiority and diminish substantive defects in their strategies.

When a company remains unresponsive in the face of a majority of shareholders seeking not only technical clarity and compliance with its resolution, but problem-solving leadership consistent with the historical leadership profile of the company, then the exercise of additional shareholder rights is in order.

## Shareholders have two immediate paths they can take:

The first is simply to cast a "no" vote for one or all of the company's proposed board of directors. The company's report is plainly unresponsive to shareholders' specific requests.

[37] http://cdn.exxonmobil.com/~/media/global/files/energy-and-environment/2018-energy-and-carbon-summary.pdf, footnote 26, p. 25. The company begins to define how the property plant and equipment line is constructed. What would be necessary here for a more complete understanding is a listing of all the company's and the various valuation assumptions used to reach ExxonMobil's total that its PPE is $255 billion.

Elevating the discussion to a vote of no confidence at the board level would reflect shareholders' dissatisfaction with the report and the underlying views it reflects.

Second, shareholders could invoke proxy access rights that allow certain large shareholders to offer a limited number of candidates for board consideration.[38] Such a step is logical when a company's board is unresponsive to shareholders' clear requests.

*Kathy Hipple is the finance professor at Bard's MBA for sustainability program and a former international institutional investment advisor at Merrill Lynch. Tom Sanzillo is IEEFA's director of finance.*

[38] https://www.cii.org/proxy_access