



## MEMO

**SUBJECT:** Grounds for a **Yes** vote on ConocoPhillips shareholder resolution requesting the company to adopt greenhouse gas reduction targets *and* a **Yes** vote on ConocoPhillips shareholder resolution concerning financial risks resulting from climate change.

**DATE:** March 31, 2011

**CONTACTS:** Rev. William Somplatsky-Jarman, Presbyterian Church (U.S.A.)  
(888) 728-7228 x5809, [bsomplat@ctr.pcusa.org](mailto:bsomplat@ctr.pcusa.org)

Tim Smith, Walden Asset Management  
(617) 726-7155, [tsmith@bostontrust.com](mailto:tsmith@bostontrust.com)

Stephen Viederman, The Christopher Reynolds Foundation  
(212) 639-9497, [sviederman@gmail.com](mailto:sviederman@gmail.com)

Andrew Logan, Ceres  
(617) 247-0700 x133, [logan@ceres.org](mailto:logan@ceres.org)

---

### **Resolved:**

*“Shareholders request that the Board of Directors adopt quantitative goals, based on current technologies, for reducing total greenhouse gas emissions from the Company’s products and operations; and that the Company report (omitting proprietary information and prepared at reasonable cost) to shareholders by September 30, 2011, on its plan to achieve these goals.”*

### **Resolved:**

*“Investors request ConocoPhillips’ Board of Directors to prepare a report to shareowners on the financial risks resulting from climate change and its impacts on shareowner value over time, as well as actions the Board deems necessary to provide long-term protection of our business interests and shareowner value. The Board shall decide the parameters of the study and summary report. A summary report will be made available to investors by September 15, 2011. Cost of preparation will be kept within reasonable limits and proprietary information omitted.”*

### **Rationale for a Yes vote:**

- 1. ConocoPhillips’ shareholders bear significant financial and competitive risks** if the company is unprepared to meet existing and impending requirements to reduce greenhouse gas (GHG) emissions from its operations and its products. The company should provide specific disclosure of such risks. Company-wide quantitative reduction goals for products and operations provide the clearest signal to investors that Conoco is prepared for a low carbon future.

2. **ConocoPhillips provides inadequate disclosure of the financial risks of climate change**, as its 10-K disclosures lack the specificity needed to help investors understand the financial implications of climate change on the company.
3. **Without improved disclosure and GHG goals, shareholders cannot adequately assess the risks of their investment in ConocoPhillips.**

### **CONOCOPHILLIPS' SHAREHOLDERS BEAR SIGNIFICANT FINANCIAL AND COMPETITIVE RISKS**

By virtue of its carbon-intensive products and long capital horizons, the oil sector is uniquely exposed to regulatory and competitive risks resulting from climate change. Investors need to know which companies are prepared for these risks – and which are not.

Numerous regulations exist or have been proposed relating to GHG emissions – including regulations that have direct impacts on the oil sector. ConocoPhillips, to its credit, discloses many of these regulatory risks in its 2010 10-K, citing, for example, EPA's "endangerment and cause or contribute finding" for greenhouse gases under the Clean Air Act (which allows EPA to craft rules that directly regulate GHG emissions), California's Global Warming Solutions Act, the European Union Emissions Trading Scheme, and climate regulations issued by the government of Alberta.<sup>1</sup> ConocoPhillips also discloses in its 10-K the "growing consensus that some form of regulation will be forthcoming at the federal level with respect to GHG emissions."<sup>2</sup> ConocoPhillips operates in over 30 countries, and international action on climate change continues, most recently with the Cancun climate conference in December. The company also discloses other types of regulations that specifically affect its main product – fuels – such as the renewable fuels standard in the Energy Independence and Security Act of 2007.<sup>3</sup> Other such regulations could include low carbon fuel standards (e.g., the EU, California) and the tailpipe GHG emissions standard set by EPA for vehicles sold through 2016.

As a fully-integrated international energy company, ConocoPhillips is exposed to all of these regulatory risks. The company recognizes that GHG laws and regulations "could significantly increase our costs, reduce demand for fossil energy derived products, impact the cost and availability of capital[, ...] increase our exposure to litigation[, and] increase demand for less carbon intensive energy sources, including natural gas."<sup>4</sup> The company also acknowledges that "environmental laws and regulations, including those that may arise to address concerns about global climate change, are expected to continue to have an increasing impact on our operations in the United States and in other countries in which we operate"<sup>5</sup> and that laws focusing on GHG reduction, if enacted, "could have a material impact on our results of operations and financial condition."<sup>6</sup> The company is therefore aware of the financial and competitive risks posed by climate change and responses to it.

---

<sup>1</sup> ConocoPhillips 2010 10-K, p.60

<sup>2</sup> ConocoPhillips 2010 10-K, p.60

<sup>3</sup> ConocoPhillips 2010 10-K, p.58

<sup>4</sup> ConocoPhillips 2010 10-K, p.60

<sup>5</sup> ConocoPhillips 2010 10-K, p.58

<sup>6</sup> ConocoPhillips 2010 10-K, p.60

For several years, ConocoPhillips has acknowledged the importance of addressing global climate change and has said it was developing internal GHG targets for its operations, a process the company says is underway. However, no targets for reductions have been established (or at least made public) after all this time. Setting targets is an important step in the development of a comprehensive long-term strategy to significantly reduce GHG emissions from operations and products. The company also does not disclose specifics on the financial risks of climate change, which would help investors assess the potential impacts of the risks described above and the potential effectiveness of the company's strategies. **Without quantitative product and operational goals and more specific disclosure of the financial risks of climate change, it will be difficult for investors to assess the expected results of ConocoPhillips' climate-related strategies.** ConocoPhillips' shareholders need to know that management is taking these issues seriously and is acting accordingly.

### **CONOCOPHILLIPS PROVIDES INADEQUATE DISCLOSURE OF THE FINANCIAL RISKS OF CLIMATE CHANGE**

While ConocoPhillips has begun to address the risks related to climate change in its 10-K and in special reports like the Carbon Disclosure Project (CDP), presently its 2010 10-K disclosures lack the specificity needed to help investors understand the financial implications of climate change on the company. The 10-K includes general statements such as the following:

*Laws in this field [i.e., focusing on GHG reductions] continue to evolve, and while it is not possible to accurately estimate either a timetable for implementation or our future compliance costs relating to implementation, such laws, if enacted, could have a material impact on our results of operations and financial condition. ... The ultimate impact on our financial performance, either positive or negative, will depend on a number of factors, including but not limited to: Whether and to what extent legislation is enacted; The nature of the legislation (such as a cap and trade system or a tax on emissions); The GHG reductions required; The price and availability of offsets; The amount and allocation of allowances; Technological and scientific developments leading to new products or services; Any potential significant physical effects of climate change (such as increased severe weather events, changes in sea levels and changes in temperature); Whether, and the extent to which, increased compliance costs are ultimately reflected in the prices of our products and services.<sup>7</sup>*

It is possible to provide the more specific information sought by investors. For example:

- Financial consultancies such as RiskMetrics Group have confirmed that climate change poses a financial risk for companies and that the correlation between climate risks and opportunities with financial performance is quantifiable. RiskMetrics has noted that physical, litigation, regulatory, competitive, and reputational risks can each affect CAPEX, operating costs, cash flow, and cost of capital and that the cost of compliance with carbon regulations can be calculated as “a percentage of EBITDA and market cap, based on company-specific carbon footprints and regional regulatory assessments.” For

---

<sup>7</sup> ConocoPhillips 2010 10-K, p.60

example, a company could use minimum, maximum, and expected cases to take into account the range of possibilities:<sup>8</sup>

	Exp. Case	Min.Case	Max. Case
Carbon Price (\$/t CO2e)	\$28	\$18	\$45
Annual Cost of Compliance (\$1000)	\$1,372	\$918	\$2,197
Exposure (% of EBITDA)	0.2%	0.1%	0.3%
NPV of Abatement Costs (\$1000)	\$5,596	\$4,195	\$10,676
Exposure (% of Mkt. Cap.)	0.5%	0.4%	0.9%

- RepuTex similarly offers the possibility of quantifying carbon and climate risks for companies. It notes, for instance, that low revenue and high EBITDA impact can indicate a company in the materials sector that is unable to pass on any carbon costs in the form of higher prices.<sup>9</sup>
- A 2009 McKinsey report confirms the necessity for companies to measure their costs in detail. The report explains that due to high energy-demand growth, companies will have to choose between allocating scarce capital and engineering capacity to their core business or to energy conservation programs. Most GHG abatement levers require high upfront capital investments, followed by savings in operating expenditures due to reduced energy requirements.<sup>10</sup> It is therefore important that companies have climate risks and opportunities estimated and quantified, since otherwise their strategies may fall short of what is necessary or feasible.

ConocoPhillips' 2010 CDP response – and the company's statement opposing the resolution concerning financial risks resulting from climate change – already describes the following financial calculations related to climate risk:<sup>11</sup>

*“All projects and acquisitions, operated and non-operated, that are expected to result in a GHG emissions change of greater than 50,000 metric tons CO2 equivalent (net to ConocoPhillips) during any year of project operation or that will cost more than \$75million are required to complete a climate change assessment. Project teams are required to assess the potential risk and opportunity for a project associated with GHG emissions, GHG regulation and a physically changing climate. This assessment is included as a requirement for project and investment approval. ... For operations in countries with existing or imminent GHG regulation, the cost of regulatory compliance is evaluated based*

<sup>8</sup> RiskMetrics Group, *Guide to Climate Risk Management* (2010), slides 3, 13, 14, available at <http://www.slideshare.net/Micheal22/microsoft-powerpoint-guidetoclimate-risk-managementppt>

<sup>9</sup> RepuTex, *Quantifying Carbon & Climate Risk for Companies* (2010), available at [http://www.asria.org/events/hongkong/cdf/post/4.%20Hugh%20Grossman%20-%20Carbon%20Risk%20and%20Exposure\\_RepuTex\\_FINAL%200410.ppt.pdf](http://www.asria.org/events/hongkong/cdf/post/4.%20Hugh%20Grossman%20-%20Carbon%20Risk%20and%20Exposure_RepuTex_FINAL%200410.ppt.pdf)

<sup>10</sup> McKinsey & Company, *Pathways to a Low-Carbon Economy, Version 2 of the Global Greenhouse Gas Abatement Cost Curve* (2009), pp. 72-73, available at <https://solutions.mckinsey.com/ClimateDesk/default.aspx>

<sup>11</sup> Conoco Phillips 2010 Response to the Carbon Disclosure Project, question 2.1, [http://www.conocophillips.com/EN/susdev/environment/climatechange/Documents/ConocoPhillips\\_2010\\_Carbon\\_Disclosure\\_Project\\_Response.pdf](http://www.conocophillips.com/EN/susdev/environment/climatechange/Documents/ConocoPhillips_2010_Carbon_Disclosure_Project_Response.pdf)

*on specific regulation and local carbon pricing information. This information is incorporated into the base-case economic analysis for ongoing and new capital expenditures. For operations in countries without existing or imminent GHG regulation, all capital projects with a cost of \$75 million or greater or which result in a change to annual emissions in excess of 10,000 metric ton of CO2 equivalent are required to use a cost of carbon as a sensitivity to the project economics for management review.”*

The report investors are seeking in the shareholder resolution should include the kind of information described above. For example, what range of carbon costs is ConocoPhillips using to analyze projects? (Companies like BP and Suncor disclose this information.<sup>12</sup>) How sensitive are financial returns of major projects to the assumed range of carbon costs? How sensitive are Conoco’s total financial returns to the range of carbon costs? The company declares in its CDP response, however, that “ConocoPhillips does not publish a detailed breakdown of the financial implications associated with climate change or any other environmental issue. In addition, the company does not publish quantitative estimates of future expenses or other potential impacts to our business related to climate change.”<sup>13</sup> It further states that “the company does not report financial data on specific renewable and clean energy investments and opportunities”.<sup>14</sup> This information would help investors assess the financial risks ConocoPhillips faces from climate change.

#### **WITHOUT IMPROVED DISCLOSURE AND GHG GOALS, SHAREHOLDERS CANNOT ADEQUATELY ASSESS THE RISKS OF THEIR INVESTMENT IN CONOCOPHILLIPS**

The oil majors, including ConocoPhillips, clearly face substantial financial risks related to climate change. Their basic business model of extracting hydrocarbons and selling them primarily for burning without capturing GHGs is now under serious threat.

To their credit, some of the companies, including ConocoPhillips, seem to have developed certain financial procedures to help manage the risks. However, ConocoPhillips is not yet sharing its estimates of the financial risks with shareholders. We believe ConocoPhillips should do so in the report requested by the resolution. Without this report, shareholders lack important information related to: 1) quantified estimates of financial risks of major company projects related to climate change; and 2) how ConocoPhillips plans to deploy financial resources to mitigate these profound risks. Investors also need to understand management’s opinions on the estimated range of impacts of climate change on shareholder value over time. It should be possible to arrive at these estimates in part by aggregating the project level estimates that company management says the company already produces. This is a vitally important set of information for investors to have. If ConocoPhillips does not disclose this kind of information, it appears as if the company does not have an accurate sense of the financial costs and therefore cannot manage the risks adequately.

---

<sup>12</sup> BP 2010 20-F, p.73; Suncor 2010 40-F, p.61

<sup>13</sup> ConocoPhillips 2010 CDP response, question 5.5

<sup>14</sup> ConocoPhillips 2010 CDP response, question 6.5

Similarly, by not setting GHG reduction goals, ConocoPhillips has fallen behind the competition and has made it very difficult for investors to evaluate its strategies to address the profound risks and opportunities associated with climate change. As shown in the chart below, ConocoPhillips is lagging behind competitors who have already set company-wide emissions targets, at least for operations.

<b>Chevron</b>	<b>Shell</b>	<b>Total</b>	<b>ConocoPhillips</b>
<b>Quant Goal:</b> Preliminary goal for 2010 was 59 million metric tons, slightly higher than 2009's actual emissions. <sup>15</sup>	<b>Quant Goal:</b> Reduce GHG emissions from operations by 5% relative to a 1990 baseline for all facilities globally under operational control. <sup>16</sup>	<b>Quant Goal:</b> (a) reduce flaring of gas by 50% between 2005 and 2014; (b) Boost efficiency 1% per year for refining and 2% per year for Exploration & Production. <sup>17</sup>	<b>Quant Goal:</b> None identified under the goals sections of Conoco's 2010 CDP response (or elsewhere). Any goals are within business units, not company-wide. <sup>18</sup>

Regulations such as those in the EU, U.S., and California are increasingly focusing on product emissions including lifecycle emissions from 'wells to wheels', making this an important emerging risk that needs managing in addition to the targets needed for emissions from operations. Conoco's 2010 CDP response notes that it does not report GHG emissions from its products but that interested parties can estimate the emissions by multiplying the volume of a product sold by the appropriate GHG co-efficient from the Energy Information Administration.<sup>19</sup> It also notes that use of its products can enable third parties to avoid GHG emissions, noting the GHG benefits of combusting natural gas instead of coal in the electricity and industrial sectors.<sup>20</sup> So the company seems at least somewhat aware of the potential opportunities for it to reduce GHG emissions from products. Having a GHG reduction target for emissions from products would let investors know the company is seriously preparing for a carbon-constrained world. Companies in other sectors whose products are at risk from climate-related regulatory and consumer-preference changes (e.g., Ford in the auto sector) have set GHG reduction targets for their products.<sup>21</sup> ConocoPhillips needs to do the same, to demonstrate to shareholders that our company can survive and thrive in the context of current and proposed regulations of greenhouse gases.

Without the financial risk information and GHG goals, shareholders cannot fully assess the risks associated with their ownership of shares in ConocoPhillips.

<sup>15</sup> Chevron 2010 CDP response, question 9.1

<sup>16</sup> Shell 2010 20-F, p.50

<sup>17</sup> Total 2010 CDP response, question 9.1

<sup>18</sup> ConocoPhillips 2010 CDP response, question 9.1

<sup>19</sup> ConocoPhillips 2010 CDP response, question 15.1

<sup>20</sup> ConocoPhillips 2010 CDP response, questions 16.1, 16.2

<sup>21</sup> [http://www.iccr.org/news/press\\_releases/2008/pr\\_ford04.09.08.htm](http://www.iccr.org/news/press_releases/2008/pr_ford04.09.08.htm)