March 2024

Ceres Investor Guidance for Engaging on Oil and Gas Sector Public Policy

Developed in consultation with Climate Action 100+ investor signatory members of Ceres' Carbon Asset Risk Working Group

Climate change poses significant risks to the global economy, to investors and companies, and to workers and communities. In 2023, the U.S. experienced 28 separate billion-dollar weather and climate disasters, while China suffered direct economic losses of about $48 billion (345.45 billion yuan) from natural disasters. Limiting global warming in line with the goals of the Paris Agreement[1] requires that all sectors adapt to curtail risks and unlock the opportunities of the transition. This is particularly true for the oil and gas industry, a significant source of greenhouse gas emissions, which will need to change profoundly as climate-related risks increase and fossil fuel demand decreases. It is critically important for companies and the industry to transition in an orderly manner – while protecting workers, contractors, and communities.

Many oil and gas companies have made commitments to net zero greenhouse gas emissions that are predicated on the implementation of supportive public policy and technological advancement.[2] Support of robust climate policies required for the achievement of these corporate goals is in the industry's financial interests, and would enable and facilitate the necessary investments to ensure financial viability in a low-emission future. To date, however, few if any oil and gas companies have articulated what this sort of supportive policy environment looks like in practice.

Given this gap between interest and action, select investors from Ceres' Carbon Asset Risk Working Group (North America) have identified critical steps needed to enable the oil and gas sector's transition to a Paris-aligned economy, while supporting companies' net zero transitions. The guidance below covers:

- **Emissions disclosure, reduction and cap**
- **Climate-related physical risks disclosure**
- **Incentivization of low-emission solutions**
- **Tightening of permitting requirements**
- **Accounting for climate-related risks in financial statements, including liabilities and current asset valuations**
- **Infrastructure decommissioning**
- **Transparency around policy engagement activities**

These recommendations can be a tool both for investors (to assess how companies are aligning their climate lobbying and policy advocacy activities with the goals of the Paris Agreement) and for companies (clear articulation of what they should support, or at least not actively obstruct, in their own financial interests and in pursuit of a Paris-aligned future). See also the Global Standard for Responsible Climate Lobbying.

For the energy transition to be successful, public policies must address the fundamental factors of reliability, affordability, safety, justice, and equity, and should bring more certainty for the oil and gas sector. Critically, enforcement provisions are of equal importance to the rules themselves, and both public and private oil and gas companies should be held to the same standards.

Ensure accurate and standardized greenhouse gas emissions measurement and disclosure

What gets measured gets managed. Regulations or public policies should require:

- Disclosure of absolute scope 1 and scope 2 emissions, as well as of scope 3 emissions deemed most material (and representing a substantial portion of the company's scope 3 emissions), using both the equity share and the operational control approaches, on at least an annual basis.
- Accurate methane emissions measurement, quantification, and reporting, at least in line with levels 4 and 5 of the Oil and Gas Methane Partnership 2.0 (i.e., integrating bottom-up source-level reporting with independent site-level measurements).
- Reasonable assurance of greenhouse gas emissions disclosure, by qualified, independent firms.

Disclose climate-related physical risks and opportunities

Regulations or public policies should require:

- Detailed disclosure of climate-related physical risks, at the asset level, for company assets and third-party assets on which the company's business depends, and including both risks that are event-driven and those that are due to long-term shifts in climate patterns, on at least an annual basis.
- Assessment of assets and business resilience against multiple, clearly identified, and explained climate scenarios.

Ambitiously and continuously reduce methane emissions to a near-zero intensity by 2030

Cutting methane emissions is key to limiting near-term climate change. Methane is a greenhouse gas and pollutant over 80 times more powerful than carbon dioxide in its first two decades after release and is the main component of natural gas. In the oil and gas industry, methane emissions represent lost product and can pose safety risks. If inadequately addressed, methane emissions may limit domestic companies' access to global gas export markets and increase their operational and financial risks.

Regulations or public policies should require:

- Rapid detection, quantification, and repair of natural gas leaks throughout the value chain.
- Mitigation of all potentially significant sources of oil and gas industry methane emissions, including low producing, inactive, and abandoned wells.
- Proper operation of enclosed combustors or flares with a minimum 99% efficiency.
- Prioritization of methane capture over gas venting and flaring, such that flaring along the whole value chain is kept to below 1% and that non-emergency-related flaring is eliminated.
- Replacement of emitting devices (including process controllers and pumps) with zero-emission alternatives.
- Development and deployment of innovative technologies for emissions mitigation.
- Commitment by companies to achieve at least a 60-75% reduction in methane emissions by 2030 from 2015 levels, or near-zero methane intensity (total volume of methane emissions divided by total volume of marketed gas) by 2030, and to continuously manage and reduce methane emissions after the target reductions are met.
- Permission for and protection of credible, qualified third-party entities to engage in site-specific monitoring of methane emissions and to notify relevant regulatory agencies in case of large releases.

Ambitiously and continuously reduce greenhouse gas emissions to net zero by 2050

Regulations or public policies should require:

- Companies to set greenhouse gas emissions reduction targets in line with the goals of the Paris Agreement.
- Companies to publish their detailed, concrete plan for how they will achieve their targets.
- Companies to disclose progress against their greenhouse gas emissions reduction targets on at least an annual basis, including the source(s) of the reductions.

Incentivize the deployment of low-emission solutions

Regulations or public policies should:

- Support the development of renewable energy.
- Favor lowest-emission, most durable, and most affordable projects.
- Support outreach and community education efforts that increase understanding of and access to these programs and projects.

- Support energy efficiency measures, including solutions for low-income, marginalized communities.
- Support electrification (for example via accelerated deployment of heat pumps and electric vehicles) and investment into electricity grids and zero-emission electricity generation.
- Allow for the development of geothermal energy and thermal networks where relevant and lowest-emission option.
- Support the deployment of green hydrogen produced from new renewable energy sources matched hourly and regionally,[3] for use in hard-to-electrify applications only.
- Support the deployment of low-emission fuels (such as e-fuels, biofuels) in hard-to-electrify applications only, provided they have demonstrably and significantly (>50%) lower emissions on a full life-cycle basis (including indirect land-use change emissions).
- Ensure health, environmental justice, and just transition factors have been taken into consideration in the design of regulations or public policies, and communities have been actively involved in the process from the start.
- Develop (or leverage existing) economic incentives for low-emission solutions (in the U.S., the Inflation Reduction Act and Infrastructure Investment and Jobs Act on methane emissions reduction, energy efficiency, electrification, renewable energy deployment, or green hydrogen production).
- Phase out fossil fuel subsidies that do not address energy poverty or just transition.

Cap greenhouse gas emissions

Regulations or public policies should:

- Cap greenhouse gas emissions, with a continuous reduction of the cap in line with or in excess of the goals of the Paris Agreement.
- Apply carbon border adjustment and/or other trade mechanisms (based on verified region-to-region comparison of emissions intensity of produced goods) to support domestic investment in decarbonization, maintain global competitiveness of domestic industries, protect international trade, maintain stable and fair carbon pricing, and reduce the risk of carbon leakage.
- Use the proceeds of any cap-and-trade framework or greenhouse gas levy to finance decarbonization.
- Ensure health and environmental justice factors have been taken into consideration in the design of any cap-and-trade mechanism.

Tighten permitting requirements to cover greenhouse gas emissions and impacts on water and biodiversity

Regulations or public policies relating to siting and permitting should require oil and gas projects (from upstream to downstream) to address the following aspects:

- Firm agreements for sufficient takeaway capacity in case of drilling permits.
- Firm commitments to minimize methane emissions and flaring in line with principles above.
- Genuine consideration for environment, biodiversity, water, health, the social cost of carbon, and environmental justice factors.
- Minimizing the harm on-site and prioritizing nature-based solutions where practicable.
- Active and early involvement of impacted communities and other stakeholders from the start of the permitting process.
- Requiring the free, prior, and informed consent from Indigenous communities, where applicable.
- Development of a credible just transition strategy, including acknowledgment of freedom of association of current workforce.
- Full accounting for the cost of asset retirement obligations, including land and ecosystem restoration (see below).

Regulations or public policies should increase renewable energy capacity and increase electricity transmission and distribution networks and interconnectivity amongst grids (provided health, water, biodiversity, and environmental justice factors are properly considered).

Properly account for climate-related risks and opportunities in financial statements

Accounting for the financial impacts of climate-related risks is critical to providing investors with an accurate understanding of a company's exposure to climate risk. Existing accounting and disclosure principles require companies to be transparent to investors about how their choices and strategies bear on their financial statements today. Full and good-faith implementation of these principles across the oil and gas sector not only leads to more reliable and accurate reporting, it also contributes to reducing systemic risks. In this context, enforcement of existing accounting and disclosure principles should ensure:

- Companies disclose financial impacts of climate change, the energy transition, and their own strategy vis-a-vis the transition in their financial statements. That includes disclosure of assumptions, costs, estimates, and valuations underlying the financial statements, including those related to long-term commodity and carbon prices, remaining asset lives, future asset retirement obligations, capital expenditures, and impairments.

- Companies include robust discussion of the current and anticipated effect of climate change and the energy transition on the company in the narrative portion of their financial reports.
- Audit committees direct rigorous consideration of climate-related impacts on financial reporting and provide for robust audits that consider climate and the energy transition.
- External auditors demonstrate that they have taken climate impacts and the energy transition into account in accordance with existing standards and considering what is material to investors.

This is detailed in the investor expectations report Lifting the Veil: "[e]stimates of future cash flows are the bedrock of both financial planning and financial reporting. Embedded in them are assumptions about future commodity prices. They translate estimates about the future into present day asset values, liabilities. However, according to the Carbon Tracker report Flying Blind, most oil and gas companies exclude the financial impacts of their climate commitments, as well as climate-related risks in their financial. To address these shortfalls, Ceres' Closing the Gap report stresses the necessity for more transparent and reliable climate-related data.

Ensure proper infrastructure decommissioning and site clean-up, and avoid the creation of orphan wells

In many jurisdictions, oil and gas companies are legally required to decommission certain long-lived tangible assets at the end of their useful life. This includes permanently sealing up wells and cleaning up sites. While this is a legal requirement for oil and gas operators, years of industry development has led to the genesis of "orphan wells," wells that are inactive, unplugged, and have no solvent owner on record. These wells emit methane, can be a safety hazard, and further pose risks to environmental and human health. The Climate Principles for Oil and Gas Mergers and Acquisitions and the Draft International Principles on the Regulation of Transactions Involving Oil and Gas Infrastructure Assets both suggest ways to ensure proper decommissioning of assets after transfer of ownership.

Regulations or public policies should:

- Enable governments to require the early retirement and decommissioning of an asset, for instance, by reclaiming the asset or denying a transaction involving the asset.
- Ensure that, from the point of project transfer or permitting, the cost of retirement obligations is fully accounted for (for all wells, including marginal wells), the holder or holders of the decommissioning liability are clearly identified, and the responsible party's mechanism for how it will assure those obligations is clearly determined.
- Ensure the disclosure of the estimated undiscounted asset retirement cost[4] (without probability adjustment) and encourage the disclosure of key assumptions in relation to the retirement provisions.
- Ensure that decommissioning is properly done, including permanent sealing up of the wells and cleaning up of the sites, land and ecosystem restoration.

- Ensure that and make public whether parent corporations are liable for their subsidiaries' decommissioning obligations or other environmental liabilities and that previous owners are liable for the buyers' decommissioning obligations or other environmental liabilities.
- Ensure all orphan wells are identified, characterized, and inventoried.
- Ensure responsible parties associated with orphan wells, their sureties, or guarantors are identified, and provide reimbursement of expenditures to the extent practicable.
- Support funding of site clean-up, including sufficient financing to permanently plug and remediate orphan wells. The responsibility for funding should lie with the oil and gas industry, and ideally with the previous owners.

Provide transparency around policy engagement activities

Regulations or public policies should require:

- Companies to annually disclose their corporate and subsidiaries' political spending and policy engagement activities, both direct and indirect, in all regions where they have activities.
- Government and public officials to annually disclose the entities or persons from whom they received policy input or financial support, the topics discussed, and the amounts received.

Endnotes

1. "The Paris Agreement's central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius." https://unfccc.int/most-requested/key-aspects-of-the-paris-agreement.

2. For instance, ExxonMobil states that "with advances in technology and the support of clear and consistent government policies, [it] aim[s] to achieve net zero operated Scope 1 and 2 greenhouse gas emissions by 2050" (Advancing Climate Solutions Progress Report, ExxonMobil, 2023. https://corporate.exxonmobil.com/-/media/global/files/advancing-climate-solutions-progress-report/2023/2023-advancing-climate-solutions-progress-report.pdf), and the Pathways Alliance relies on economic incentives to develop carbon capture projects (Kendall Dilling, President of the Pathways Alliance, issued the following statement in response to the Alberta Carbon Capture Incentive Program, Pathways Alliance, November 2023. https://pathwaysalliance.ca/news/kendall-dilling-president-of-the-pathways-alliance-issued-the-following-statement-in-response-to-the-alberta-carbon-capture-incentive-program/; Incentives uncertainty clouds Pathways Alliance economic feasibility, Wood Mackenzie, February 2024. https://www.woodmac.com/press-releases/2024-press-releases/incentives-uncertainty-clouds-pathways-alliance-economic-feasibility/).

3. This means that green hydrogen needs to be produced from renewable energy coming from new renewables projects, and generated within the same hour and in the same region as the hydrogen. This is to avoid producing green hydrogen from fossil-powered grid electricity (directly or indirectly).

4. Oil and gas companies are legally required to decommission certain long-lived tangible assets at the end of their useful life (e.g., equipment removal, site clean-up). The associated legal obligations are recognized as asset retirement obligations (AROs) by the Financial Accounting Standards Board. ARO initially should be measured at fair value and should be recognized at the time the obligation is incurred (provided that a reasonable estimate of fair value can be made). In some cases, companies do not recognize AROs on grounds that assets have indeterminate lives, meaning a fair value cannot be reasonably estimated. Disclosing the undiscounted costs associated with these material obligations would enable investors to assess the true risk-adjusted value of their investment. See for example guidance from PwC or EY (Asset retirement obligations, PwC, April 2022. https://viewpoint.pwc.com/dt/us/en/pwc/accounting_guides/financial_statement_/financial_statement___18_US/chapter_11_other_lia_US/116_asset_retirement_US.html#pwc-topic.dita_14130418121508 98, and Financial Reporting Developments - Asset retirement obligations, EY, June 2023. https://www.ey.com/en_us/assurance/accountinglink/financial-reporting-developments---asset-retirement-obligations).