

MODEL for memo on improving ESG for corporation (example)
(prepared by Victor Flatt and students at the University of Houston Law Center ESG course¹)

To: XXXXX Corporation Management Committee

From: Outside Counsel

Date: March 10, 2021

Subject: Recommendations for improving XXXX's climate-related disclosures and metrics

Questions Presented

On February 22, 2021, Engine No. 1, an activist investment firm supported by the California State Teachers' Retirement System ("CalSTRS"), sent a letter to XXXXX Corporation's ("XXXX" or "the company") Board of Directors ("the Board") questioning whether the company's greenhouse gas (GHG) emission reduction targets and capital allocation strategy are consistent with the goals of the Paris Agreement.² In response to this letter, I was asked two questions by the XXXX Management Committee:

- (1) How does XXXX's GHG emission reduction targets and capital allocation strategy compare to other supermajors³ in the industry?
- (2) How can the company's climate-related disclosures be improved?

Brief Answer

- (1) There is a clear divide between the GHG emission reduction targets and capital allocation strategies of western supermajors versus eastern supermajors.⁴ XXXX (and Chevron) (a) disclose no long-term goals for achieving net zero emissions by 2050, (b) omit Scope 3 emissions from their reduction targets, and (c) commit less than five percent of their planned capital expenditures for 2021 to low carbon initiatives. In contrast, the eastern supermajors (a) set long-term goals for achieving net zero emissions by 2050, (b) incorporate Scope 3 emissions in their reduction targets, and (c) commit fifteen percent or more of their planned capital expenditures for 2021 to low carbon initiatives.
- (2) XXXX can improve its climate-related disclosures by: (1) setting long-term emission reduction goals (in addition to its current short-term goals); (2) incorporating Scope 3 emissions in its overall emission reduction targets; and (3) articulating how its current investments in low carbon initiatives lead to reductions in Scope 3 emissions. In addition

¹ Victor Flatt is the Dwight Olds Chair in Law and the Faculty Co-Director, Environment, Energy, and Natural Resources (EENR) Center.

² Engine No. 1, *Letter to the Board of Directors* (Feb. 22, 2021), <https://reenergizexom.com/materials/letter-to-the-board-of-directors-february-22/>.

³ In addition to XXXX, the five other "supermajors" are Chevron, Shell, BP, Total, and Eni.

⁴ The "western supermajors" consist of XXXX and Chevron while the "eastern supermajors" consist of Shell, BP, Total, and Eni.

to these changes, XXXX could further improve disclosures by expanding metrics associated with water management.

Statement of Facts

XXXX currently includes climate-related disclosures in its 10-K, Carbon and Energy Summary, and Sustainability Report.⁵ In these disclosures, the company sets short-term goals for reducing Scope 1 and 2 emissions⁶ from assets operated by the company.⁷ Specifically, the company’s goals include a fifteen to twenty percent reduction in GHG intensity of upstream operations by 2025.⁸ This broader goal of fifteen to twenty percent reduction in GHG intensity is supported by goals for reducing methane intensity by forty to fifty percent and flaring intensity by thirty-five to forty-five percent.⁹ The company does not include long-term goals for achieving net zero emissions by 2050 in any of its disclosures.¹⁰

In relation to its emission reduction goals, XXXX has announced planned capital spending in the range of sixteen to nineteen billion dollars for 2021.¹¹ Included in this announcement was a commitment to spend \$3 billion dollars on Carbon Capture, Utilization, and Storage (“CCUS”) over the next five years.¹² Assuming this \$3 billion dollar commitment in CCUS is spent pro rata over the five-year period, XXXX’s relative allocation of capital between low carbon and traditional oil and gas investments for 2021 is as follows:

	Dollar Value	Percentage
Traditional investments	\$15.4-18.4 bln	> 96%

⁵ See XXXX Corp., *2021 Energy & Carbon Summary* (Jan. 5, 2021), <https://corporate.XXXX.com/-/media/Global/Files/energy-and-carbon-summary/Energy-and-carbon-summary.pdf>; XXXX Corp., *SEC Form 10-K* (Feb. 24, 2021)**Error! Hyperlink reference not valid.**; XXXX Corp., *Sustainability Report* (Jan. 2021), <https://corporate.XXXX.com/Sustainability/Sustainability-Report>.

⁶ The U.S. Energy Information Agency (“EIA”) defines Scope 1 emissions as “direct GHG emissions from sources that are owned or controlled by an entity,” and Scope 2 emission as “direct GHG emissions that result from the generation of electricity, heat, or steam purchased by an entity.”

⁷ XXXX Corp., *Sustainability Report*, at 9 (Jan. 2021), <https://corporate.XXXX.com/Sustainability/Sustainability-Report>.

⁸ *Id.*

⁹ *Id.*

¹⁰ See XXXX Corp., *SEC Form 10-K* (Feb. 24, 2021)**Error! Hyperlink reference not valid.**; XXXX Corp., *2021 Energy & Carbon Summary* (Jan. 5, 2021), <https://corporate.XXXX.com/-/media/Global/Files/energy-and-carbon-summary/Energy-and-carbon-summary.pdf>; XXXX Corporation, *Sustainability Report* (Jan. 2021), <https://corporate.XXXX.com/Sustainability/Sustainability-Report>.

¹¹ XXXX Corp., *XXXX outlines plans to grow long-term shareholder value in lower carbon future* (Mar. 23, 2021), https://corporate.XXXX.com/News/Newsroom/News-releases/2021/0303_XXXX-outlines-plans-to-grow-long-term-shareholder-value-in-lower-carbon-future.

¹² XXXX Corp., *XXXX Low Carbon Solutions to commercialize emission-reduction technology* (Feb. 1, 2021), https://corporate.XXXX.com/News/Newsroom/News-releases/2021/0201_XXXX-Low-Carbon-Solutions-to-commercialize-emission-reduction-technology.

Low carbon initiatives ¹³	\$0.6 bln	< 4%
Total capex	\$16-19 bln	100%

Engine No. 1’s February letter to the Board responded to XXXX’s GHG emission reduction goals and its capital allocation strategy. The activist firm claimed that XXXX’s “narrow definition of emissions [is] inconsistent with Paris goals,” citing that “[the company’s] figures exclude Scope 3 emissions which account for an estimated 83% of [its] total emissions,” and that the company’s “methodology for calculating its emission reduction percentages excludes its percentage of production from ‘non-operated assets’ (such as joint ventures with other companies).”¹⁴ In addition to Engine No.1’s issues with the scope of XXXX’s emission reduction goals, Engine No. 1 argued that XXXX’s “short-term approach falls far short of Paris Agreement consistency...”¹⁵ To align with the Paris climate accord, the firm implores that Scope 3 emissions be included in XXXX’s emissions targets and the company announce long-term goals for net zero emissions by 2050.

Discussion

I. In contrast to the eastern supermajors, XXXX takes a short-term view towards emission reduction goals and excludes Scope 3 emissions from its emissions targets.

a. Short-term view of emission reduction goals

The eastern supermajors have taken a leading role among Big Oil in setting long-term GHG emission reduction goals. BP, Shell, and Total committed to the aspirational goal of net zero emissions by 2050 during the first half of 2020.¹⁶ In contrast to the eastern supermajors, the western supermajors (XXXX and Chevron) have set no long-term commitments. Instead, XXXX and Chevron have taken a short-term approach with limited emission reduction goals set for 2025 and 2023, respectively. More specifically, XXXX’s 2025 targets are limited to (1) Scope 1 and 2 emissions, (2) from upstream assets, (3) operated by the company. As shown in the chart below, this accounts for an insignificant percentage (less than 3%) of XXXX’s total emissions.

Million tonnes CO ₂ e	XXXX’s 2019 GHG Emissions by Business Line¹⁷
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¹³ “Low carbon initiatives” include (but are not limited to): wind, solar, nuclear, biofuels, hydrogen, CCUS, natural sinks, EV charging, etc.

¹⁴ Engine No. 1, *Letter to the Board of Directors* (Feb. 22, 2021), <https://reenergizexom.com/materials/letter-to-the-board-of-directors-february-22/>.

¹⁵ *Id.*

¹⁶ British Petroleum, *BP sets ambition for net zero 2050 fundamentally changing organization to deliver* (Feb. 12, 2020), <https://www.bp.com/en/global/corporate/news-and-insights/press-releases/bernard-looney-announces-new-ambition-for-bp.html>; Jillian Ambrose, *Shell unveils plans to become net zero by 2050* (April 16, 2020), <https://www.theguardian.com/business/2020/apr/16/shell-unveils-plans-to-become-net-zero-carbon-company-by-2050>; Total SE, *Total adopts a new climate ambition to get to net zero by 2050* (May 5, 2020), <https://www.total.com/media/news/total-adopts-new-climate-ambition-get-net-zero-2050>.

¹⁷ XXXX Corp., *2021 Energy & Carbon Summary*, at 38, 43 (Jan. 5, 2021), <https://corporate.XXXX.com/-/media/Global/Files/energy-and-carbon-summary/Energy-and-carbon-summary.pdf>.

	Scope 1 and 2	Scope 3	Total
Upstream	55	570	625
Downstream	42	630	672
Chemical	23	730	753
Total	120/~6%	1930/~94%	2050

b. Scope 3 emissions excluded from GHG emission reduction targets

In alignment with goals for net zero emissions by 2050, the eastern supermajors have taken ownership of consumer-based emissions associated with the use of oil and gas they produce (so-called “Scope 3” emissions). For example, Shell states that by 2050, its goal is to reduce its carbon

footprint for “all energy products sold” to net zero.¹⁸ This shows full-scope ownership by Shell over their carbon footprint.

XXXX has resisted the approach used by Shell, maintaining that Scope 3 emissions are not within the control of the company (as opposed to Scope 1 and 2 emissions). XXXX, in its 2021 Carbon & Energy Summary Report, claims that, “[u]ltimately, changes in society’s energy use coupled with the development and deployment of affordable lower-emission technologies will be required to drive meaningful Scope 3 emissions reductions.”¹⁹ As the chart above indicates, Scope 3 emissions account for approximately 94% of XXXX’s total emissions.

c. Limited investment in low carbon initiatives

The dichotomy between eastern and western supermajors is further reflected in their investment decisions. In line with their long-term views and full-scope ownership of emissions, eastern supermajors allocate three to five times more of their annual capital budgets to low-carbon energy solutions than their western counterparts. The chart below shows this distinction.

\$ Billions	2021 Capital Allocation				
	XXXX ²⁰	Chevron ²¹	Total ²²	Shell ²³	BP ²⁴
Low Carbon Capex	\$0.6	\$0.4	>\$2	\$2-3	\$2
Total Capex	\$16-19	\$14	\$12	\$19-22	\$13
Low Carbon %	< 4%	< 3%	>20%	10-16%	15%

The following table further detail the similarities and differences between the various supermajors:

¹⁸ Shell, *Shell accelerates drive for net-zero emissions with customer-first strategy* (Feb. 11, 2021), <https://www.shell.com/media/news-and-media-releases/2021/shell-accelerates-drive-for-net-zero-emissions-with-customer-first-strategy.html>.

¹⁹ XXXX Corp., *2021 Energy & Carbon Summary*, at 54 (Jan. 5, 2021), <https://corporate.XXXX.com/-/media/Global/Files/energy-and-carbon-summary/Energy-and-carbon-summary.pdf>.

²⁰ XXXX Corp., *XXXX outlines plans to grow long-term shareholder value in lower carbon future* (Mar. 23, 2021), https://corporate.XXXX.com/News/Newsroom/News-releases/2021/0303_XXXX-outlines-plans-to-grow-long-term-shareholder-value-in-lower-carbon-future.

²¹ Chevron Corp., *Chevron announces \$14 billion capital and exploratory budget for 2021* (Dec. 3, 2020), [https://www.chevron.com/stories/chevron-announces-\\$14-billion-capital-and-exploratory-budget-for-2021](https://www.chevron.com/stories/chevron-announces-$14-billion-capital-and-exploratory-budget-for-2021).

²² Total, *Results and Outlook*, (Feb. 9, 2021), https://www.total.com/system/files/documents/2021-02/2020_results_outlook.pdf.

²³ Shell, *Shell accelerates drive for net-zero emissions with customer-first strategy* (Feb. 11, 2021), <https://www.shell.com/media/news-and-media-releases/2021/shell-accelerates-drive-for-net-zero-emissions-with-customer-first-strategy.html>.

²⁴ Wood Mackenzie, *BP corporate – reported results analysis*, at 2 (Feb. 2, 2021), <https://my.woodmac.com/document/15809665>.

	GHG Emission Reduction Targets of Supermajors with Market Caps > \$75 Billion as of March 1, 2021²⁵				
	XXXX	Chevron	Total	Shell	BP
	Base year 2016	Base year 2016	Base year 2015	Base year 2016	Base year 2020
Scope 1 & 2	15 to 20% reduction in GHG intensity of upstream operations by 2025 (absolute reduction of GHG emissions of 30% for upstream) 40-50% reduction in methane intensity and 35-45% in flaring intensity by 2025 (absolute flaring and methane expected to decrease by 40-50%)	Upstream oil net GHG emission intensity by 5-10% and Upstream natural gas net GHG emission intensity by 2-5% by 2023. 20-25% reduction in methane intensity and 25-30% in flaring intensity by 2023	< 40 MtCO ₂ e by 2025, down 40% by 2030 and net zero across worldwide operations by 2050 or sooner	Net zero absolute emissions associated with all products manufactured by 2050	20% by 2025, 30-35% by 2030 and net zero on an absolute basis by 2050 or sooner
Scope 3	No target	No target	≥ 60% in carbon intensity of all energy products sold worldwide by 2050 (excluding traded products), with short term targets of 15% by 2030 and 35% by 2040. Lower absolute emissions by 2030	6-8% reduction in net carbon footprint from all energy products sold by 2023, 20% by 2030, 45% by 2035 and net zero by 2050. *Excludes trading operations and non-energy products	20% reduction in absolute emission from equity production by 2025, 35-40% by 2030 and net zero in 2050 or sooner *Includes equity production
Short-term targets?	Yes	Yes	Yes	Yes	Yes
Long-term targets?	No	No	Yes	Yes	Yes
Net Zero Goal	No	No	Yes – Scope 1, 2, & 3 (Europe Only for Scope 3)	Yes – Scope 1, 2, & 3	Yes – Scope 1, 2, & 3
Net Zero Commitment Date	No commitment	No commitment	May 5, 2020	April 16, 2020	February 12, 2020
Scope 1 & 2 targets exclude equity production	Yes	Yes	Yes	Yes	Yes
Low carbon focus	CCUS and Biofuels (Algae)	Seed investment strategy. CCUS, EV charging, nuclear fission, biofuels (dairy biomethane)	Wind, solar, CCUS, natural sinks	Wind, solar, CCUS, EV charging, hydrogen, and biofuels (sugarcane)	Wind, solar, hydrogen, CCUS, and Biofuels (sugarcane)

II. XXXX can improve its reporting by committing to long-term goals for net zero emissions, incorporating Scope 3 emissions in its overall emission reduction targets, and articulating how its current investments in low carbon initiatives lead to reductions in Scope 3 emissions.

To further its commitment towards solving climate change, XXXX should commit to long-term goals for net zero emissions. XXXX has already stated (on multiple occasions)²⁶ that it is committed to the goals of the Paris Agreement. If this true, an affirmative statement by CEO Darren Woods committing the company to net zero emissions by 2050 would signal a fundamental shift by XXXX towards recognizing its major role in combatting climate change. Furthermore, making a long-term commitment to achieve net zero emissions would simply be an extension of

²⁵ Information in this table is cited throughout memo. See also Wood Mackenzie, *Carbon emissions primer: untangling the Majors' emission reduction commitments* (Feb. 26, 2021), <https://my.woodmac.com/document/453084>.

²⁶ XXXX Corp., *Peter W. Trelenberg response to banks* (Mar. 22, 2017), <https://corporate.XXXX.com/-/media/Global/Files/climate-change/PWT-response-to-Banks.pdf>.

the short-term commitments the company has already made. Investors have responded positively to XXXX's recent addition of ESG-conscious Directors,²⁷ and I believe investors would respond positively to a long-term, net zero commitment by the company as well.

To support a long-term, net zero emissions goal, XXXX should expand the scope of emissions it includes in its emission reduction targets. Under the company's current emission reduction goals, its overall carbon footprint could grow even if Scope 1 and Scope 2 GHG emissions are reduced to zero. This highlights the absurdity of its current "goals" and calls into question the credibility of its overall commitment to combatting climate change. Moreover, investor pressure over the scope of XXXX's GHG emissions is unlikely to subside. XXXX should proactively address this investor concern and take ownership over the bulk of its carbon footprint by incorporating Scope 3 emissions in its reduction goals.

Lastly, XXXX can improve the discussion and analysis surrounding GHG emissions in its climate-related disclosures by better connecting the company's low-carbon investment decisions with corresponding reductions in full-scope (Scope 1, Scope 2, and Scope 3) emissions. Despite historical and planned future investments in CCUS technology, XXXX only mentioned its investment in CCUS twice in its 2019 Sustainability Report. Added discussion and analysis about (1) how this investment translates into full-scope emissions reductions, and (2) the relative investment towards direct air capture versus traditional CCUS technology would improve the usability of the company's climate-related disclosures. XXXX (and investors) could also benefit from reporting metrics on CCUS. Specifically, metrics disclosing the CO_{2e} captured by scope and by CCUS project would be helpful.

Conclusion

In conclusion, XXXX (and investors) could benefit from making changes to its emission reductions goals and climate-related disclosures. Specifically, I recommend: (1) setting long-term emission reduction goals (in addition to its current short-term goals); (2) incorporating Scope 3 emissions in its overall emission reduction targets; and (3) articulating how its current investments in low carbon initiatives lead to reductions in Scope 3 emissions. These changes would improve the usefulness of XXXX's climate-related disclosures, show a real commitment to combating climate change, and move XXXX closer to the eastern supermajors in the ESG space.

²⁷ Pippa Stevens, *Exxon shares jump as activist investor Jeff Ubben joins the board* (Mar. 1 2021), <https://www.cnbc.com/2021/03/01/activist-investor-jeff-ubben-to-join-exxon-mobils-board-sources-say.html>.