Investor Brief on shareholder proposal to Imperial Oil

Reasons to vote FOR the proposal to adopt a policy to cease oil and gas exploration and developments

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THE PROPOSAL

RESOLVED: Shareholders request that Imperial Oil adopt a policy to cease capital expenditures in exploration and developments of new oil and gas fields in order to align its business strategy to a net zero emissions by 2050 pathway as described in the International Energy Agency Net Zero Emissions by 2050 scenario.

Source: Appendix B, p.102 of the Imperial Oil's 2022 management proxy circular)

The proposal was submitted by Comité syndical national de retraite Bâtirente Inc. ("Bâtirente") for Imperial Oil's 2022 annual meeting of shareholders. Bâtirente is a group retirement system created at the initiative of the CSN. It allows 25,000 workers, grouped in 300 labor unions, to benefit from pension plans by pooling their savings. Æquo Shareholder Engagement Services supported Bâtirente in drafting, filing and discussing this proposal with company representatives.

To our knowledge, this is the first time this proposal is being submitted to Imperial Oil's (IMO) shareholders. The proposal proponent engaged in a dialogue with Imperial Oil to assess the possibility of withdrawing the proposal before publication of management's proxy circular but commitments by management were insufficient to allow for withdrawal.

Strategic and market risks

The International Energy Agency (IEA)'s flagship report, the World Energy Outlook 2021, provides three global scenarios for how the energy sector could evolve over the next decades. Among these scenarios, the IEA provides a Net Zero Emissions by 2050 scenario (NZE), which sets out a narrow but achievable pathway for the global energy sector to achieve net zero CO_2 emissions by 2050. In the IEA's NZE, the share of fossil fuels in the world mix drops from around its current 80% to just over 20% in 2050. Crucially, "**The rapid drop in oil and natural gas demand in the NZE means that no fossil fuel exploration is required and no new oil and natural gas fields are required beyond those that have already been approved for development.**" However, the IEA specifies that "continued investment in existing producing oil fields are needed." (IEA, Sectoral pathways to net-zero emissions by 2050).

The IEA does not provide a definition for "fields". We can assume that existing producing fields such as those found in the Athabasca oil sands deposit would not be considered a "new field". Therefore, adopting a policy as requested by the proposal would not affect infill drilling and well work at IMO's Cold Lake in situ and Kearl mining operations. However, assessments of undeveloped, mineable oil sands acreage in the region would likely fall outside of the NZE as would the Aspen SAGD project as it has not yet received a final investment decision.

Capital expenditures specifically earmarked for exploration activities would likely fall outside the NZE despite being a small fraction of overall investments by IMO (32 million $ in exploration expenses in 2021, up from 13 in 2020 and down from 47 in 2019).

- IMO holds a 25 percent interest in two exploration licences in the Beaufort Sea. Although the the Federal Government declared Arctic waters off limits to new offshore oil and gas licences in 2016, it will be reviewing this in 2023.
- IMO holds discovery licence acreage in the Mackenzie Delta and Beaufort Sea areas. (source: IMO 2021 10-K)

In light of the possible (and desirable) NZE scenario, continuing to invest in exploration and development of greenfield projects would increase the risk of stranded assets. In NZE, oil demand would fall enough to make any such investment a surplus to requirements of the scenario and could result in companies struggling "to return the capital invested" (IEA, WEO 2021).

Adopting a policy aimed at aligning capex to the NZE, as is recommended by the proposal proponent, is therefore not contradictory to pursuing “responsible exploration and development” as espoused by the board in its response. The board would have to define the scope of the policy in light of the IEA NZE scenario and could determine that drilling of new wells and expansion of existing fields is not precluded. Such a policy would not be a fundamental shift from its current path but would provide IMO investors with a reasonable level of assurance that IMO is pursuing a prudent strategy in light of the uncertainty around future demand.

Reputational and competitive risks

As the impacts of climate change increase, governments and investors are aligning with the net zero agenda and will likely become averse to supporting developments of new oil and gas fields. Nations that have adopted, in some form or another, bans on new oil and gas exploration and production include Denmark, France, Spain and Ireland.

Ceasing oil and gas exploration has entered the public discourse on climate change as illustrated by the following statements.

> “Countries should also end all new fossil fuel exploration and production, and shift fossil fuel subsidies into renewable energy.” “Investing in new fossil fuel infrastructure is moral and economic madness, (...). Such investments will soon be stranded assets, a blot on the landscape and a blight on investment portfolios.” - António Guterres, UN Secretary-General https://www.eenews.net/articles/ipcc-report-oil-renewables-and-stranded-assets/

> “If governments are serious about the climate crisis, there can be no new investments in oil, gas and coal, from now – from this year.” - Fatih Birol, Executive Director, IEA https://www.theguardian.com/environment/2021/may/18/no-new-investment-in-fossil-fuels-demands-top-energy-economist

Despite having set short and mid-term targets for reducing greenhouse gas intensity of its operations, IMO’s transition plan does not currently include targets to reduce scope 3 emissions (those emissions by end-users). Some peers such as Shell, Equinor, Repsol and Occidental have set such scope 3 targets, which would presumably have the effect of winding down exploration and development over time. Canadian peers such as Suncor and Cenovus have set absolute reduction targets which would also indicate they favor limiting exploration.

Investors will increasingly reward oil and gas companies that set long term GHG reductions goals, including scope 3 emissions. The Climate Action 100+ initiative is the world's largest investor collaboration with over 700 investors, overseeing in excess of $68 trillion in assets under management. Scope 3 reduction targets is one of the key indicators companies are measured against by CA100+.[1] Although the benchmark does not specify how companies should achieve reductions, we believe that such scope 3 targets for oil and gas companies should include the notion of limiting the growth of reserves that can only be produced decades in the future. By not sending any signal that it is considering such limits, IMO's transition plan is at risk of being looked at less favorably by investors and governments. Moreover, it may also increase competitive risk from those oil and gas companies that have chosen to limit exploration and reallocate those capex to low carbon energy production, thus to the diversification of their exposure and risks.

Banks are also coming to view oil and gas transition plans as including a winding down of exploration and development of new fields. ING, KBC, Nordea and Unicredit have announced their intention to cease financing oil and gas exploration and expansion of reserves. In Canada, CIBC has committed to work with its oil and gas clients to reduce their scope 3 emissions which, as we can reasonably expect, should lead to slowing the growth of new reserves. CIBC, BMO, Scotiabank and TD have all announced targets to reduce the financed emissions of their oil and gas lending portfolios. These include scope 3 emissions, which we can also understand to mean driving oil and gas clients to diversify to low carbon products and slowing or ceasing exploration and development of new fields.

Another driver for ceasing exploration and development of new fields is the opportunity cost of not investing in climate-solutions. Former Bank of England governor and prominent global finance adviser Mark Carney labelled the transition to net-zero as "the greatest commercial opportunity of our time."

Regulatory Risks

According to the Pembina Institute, "Despite reductions in emissions intensity per barrel, overall, Canadian crude oil remains some of the most carbon intensive in the world." Oil and gas is Canada's largest emitting sector, accounting for 26% of greenhouse gas (GHG) emissions in 2019. Between 2005 and 2019, oil and gas emissions grew by 20%, while emissions in other sectors were declining. In its *Decarbonizing Canada's oil and gas supply* report, the Pembina Institute calculated that the oil and gas industry could align to Canada's reduction target and achieve a 45% reduction by 2030 from 2005 levels. This would involve reducing methane leakages, electrification of engines and compressors, capturing and storing CO_2 and, importantly, not extending the end-of-life of facilities such as Suncor's base mine. One take away from this study is that one of the key options to reduce emissions is to limit growth

[1] The Climate Action 100+ Net Zero Company Benchmark was developed in 2020 through collaboration and feedback with nearly 50 investor signatories, experts from investor networks at AIGCC, Ceres, IIGCC, IGCC and PRI, leading research and data organizations, and other corporate stakeholders to establish assessment indicators that are robust, fair, and applicable to regional markets and across sectors. For more detail on the on the indicators, data sources and company assessment methodologies, go to: https://www.climateaction100.org/progress/net-zero-company-benchmark/

projects. Winding down exploration and development of new fields would therefore help manage regulatory risks that future caps on emissions become more stringent.

Conclusion

We urge Imperial Oil shareholders to vote in favor of the company adopting a policy to cease capital expenditures in exploration and the development of new oil and gas fields in order to align its business strategy to a net zero emissions by 2050 pathway as described in the International Energy Agency Net Zero Emissions by 2050 scenario. Such a policy would strengthen Imperial Oil’s plan to reduce emissions and provide a reasonable level of assurance to investors that the company’s business strategy is resilient in a net zero pathway such as the one described in the IEA net zero emissions scenario. It would also support the company’s capacity to comply with emissions caps and other regulations.