
Lines in the Sands: Oil Sands Sector Benchmarking *Summary*



Northwest & Ethical Investments L.P.



Who We Are

This report was written by Michelle de Cordova (Manager, Sustainability Research) and Jamie Bonham (Senior Sustainability Analyst) with the assistance of the Sustainability Department at Northwest & Ethical Investments L.P. The benchmarking project was conducted with the support of the National Union of Public and General Employees and Ceres.

Northwest & Ethical Investments L.P. has \$4.5 billion in assets under management. Through its Ethical Funds division, it is Canada's largest provider of socially responsible mutual funds. The Ethical Funds approach to investing is based on the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will provide higher risk-adjusted returns over the long term.

The 340,000-member National Union of Public and General Employees (NUPGE) is a family of 11 component unions. Taken together, it is one of the largest unions in Canada. NUPGE is committed to a joint trusteeship governance model for all its members' pension plans. Currently, the components of NUPGE have trustees on 10 of the largest public sector pension plans in four provinces in Canada. Together, those jointly-trusted pension plans have over C\$100 billion in assets. Within the joint trusteeship model, NUPGE promotes investment strategies that recognize the importance of ESG issues in protecting the broad and long-term interests of its members.

Ceres is a leading coalition of investors, environmental groups and other public interest organizations working with companies to address sustainability challenges, such as global climate change. Ceres coordinates the Investor Network on Climate Risk (INCR), a group of 80 institutional investors and investment firms with collective assets totalling more than US\$8 trillion.

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Summary

Alberta’s oil sands place the province second only to Saudi Arabia in the account of global oil reserves, and almost every major Canadian and international oil company is (or plans to be) involved in the development of the resource. But the oil sands have become a focus of global criticism because of the industry’s heavy environmental and social impacts—impacts that can generate a complex of litigious, regulatory, policy and social license risks to shareholder value. As more companies enter the oil sands, and the contribution of oil sands to company reserves increases, more investors are becoming exposed to these risks, and the level of their exposure is increasing.

Investors can manage risk and contribute to corporate change by informed investment decision-making, by engaging the companies they own, and by offering their perspective in policy consultations. To do so effectively, investors need to understand sector risks, and how they apply to specific companies: this is why we carry out benchmarking research.

For this benchmarking exercise, we limited the scope of our research to 13 publicly-traded companies currently operating commercial-scale oil sands projects.

We considered each company’s exposure to environmental, social and governance (ESG) risk in the following areas:

- Disclosure
- Aboriginal engagement
- Climate change and air pollution
- Water
- Land use, biodiversity and reclamation
- Strategy for change.

Eleven out of 13 companies completed the benchmarking survey, and seven companies met with us during the research process for in-depth discussions. Imperial and Husky declined to respond to the questionnaire, referring us instead to their public disclosure.¹

PUBLIC COMPANIES WITH OIL SANDS INTERESTS

- BP (future)*
- Canadian Natural Resources*
- Canadian Oil Sands Trust*
- Chevron
- Connacher Oil and Gas*
- ConocoPhillips*
- Devon Energy*
- EnCana*
- Exxon (future)*
- Husky Energy*
- Imperial Oil*
- Ivanhoe Energy (future)*
- Japan Petroleum Exploration — Japan Canada Oil Sands
- Marathon Oil
- Murphy Oil
- Nexen*
- Nippon Oil Exploration
- Mocal Energy
- OPTI Canada
- Pengrowth Energy Trust (future)*
- Petrobank Energy
- Shell*
- StatoilHydro (future)*
- Suncor Energy* / Petro-Canada*
- Teck (future)*
- Total*
- UTS Energy (future)*

*=included in benchmarking

	DISCLOSURE	FIRST NATIONS	AIR	WATER	LAND	STRATEGY
CNRL	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇
Connacher	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇
Conoco	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇
COS	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇
Devon	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆
EnCana	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇
Husky	◆◆◆◆◆	◆◆◆◆◆	◆◆◆◆◆	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◆
Imperial	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆	◆◆◆◆◇
Nexen	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◆
Petro-Can	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇
Shell	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇
Suncor	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇
Total	◆◆◆◆◇	◆◆◆◆◇	N/A	N/A	◆◆◆◆◇	◆◆◆◆◇
AVERAGE	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇	◆◆◆◆◇

Performance Risk:

◆◆◆◆◆ **Higher risk:**
The company failed to disclose, or disclosed minimal or non-existent risk mitigation policies and practices under this theme.

◆◆◆◆◇ **Lower risk:**
The company disclosed robust risk mitigation policies and practices under this theme.

¹ Imperial and Husky have since agreed to meet with Northwest & Ethical Investments staff to discuss the findings of this study.

Investors have a right to disclosure of material company information that could affect investment decision-making. Nexen, Suncor and ConocoPhillips stood out for the relative quality and completeness of their public disclosure. At the other end of the spectrum, it is cause for concern that Imperial and Husky either did not consider the issues we raised to be material, or were unaware that their public disclosure did not contain the information we sought. With a few exceptions, companies do not break down ESG-related reporting by business unit, making it difficult for investors to assess the specific risks associated with oil sands operations. Overall, disclosure was weakest on the themes of land and strategy for change.

All oil sands companies in our survey operate in areas overlapping Aboriginal traditional territories. Because Aboriginal rights claims are a matter to be determined between the communities concerned and the Crown, risk to company value cannot be wholly eliminated by company action—but it can be mitigated through an effective engagement strategy. Performance on this theme varied widely, with higher scores for companies with strong roots in the region. Worryingly, only a handful of companies acknowledge in public disclosure the risk posed by aboriginal rights litigation; only a third recognize treaty rights in their Aboriginal policies, and none incorporate the principle of Free, Prior and Informed Consent; and few base their consultation approaches on guidelines endorsed by Aboriginal communities themselves. Over a third of operators did not disclose the existence of even basic agreements with any impacted communities.

Compared to other oil sands operators, Shell stood out for the *relative* carbon efficiency of its projects. It was the only company with targets for absolute emissions reductions, and the company that had most strikingly reduced its absolute global emissions—although this can be attributed partly to a declining production trend over the past several years. Other companies lacked even emissions intensity targets to reduce exposure to current Alberta regulations. Companies are pursuing a variety of approaches to emissions control, ranging from alternative extraction methods and energy efficiency to carbon capture and storage (CCS). Although a few companies are taking significant steps to make the technology a reality, more display an apparent credibility gap between words and action on CCS. A further cause for concern is absence of targets and weak performance across the sector on reduction of emissions of health-impacting criteria air contaminants (nitrogen oxides, sulphur dioxide, volatile organic compounds and particulates).

Industry insiders cite water access as a showstopper issue, but erratic disclosure makes it hard for investors to assess the risk. Half the companies failed to provide data, or presented it in an ambiguous way that made comparison difficult. Less than a quarter disclosed any kind of water management targets. Only Suncor had absolute water use targets – even though as a legacy operator with a generous license provision it is among the least exposed to water access regulatory risk. Most in situ operators are already compliant with draft regulatory requirements, and use of saline rather than fresh groundwater appears to be on the rise.

Performance on the theme of land was poor across the sector. The absence of a strategic land use plan for the oil sands region places project capital investments at risk from future policy and regulatory decisions. Yet companies have a history of failing to advance multi-stakeholder planning initiatives, and none express support for the idea of a development moratorium until planning is complete. Only Suncor and Syncrude provide investor-oriented disclosure on reclamation progress, and their reclamation rates are diminishing or static. More positively, several companies are already involved in biodiversity offsetting initiatives, although it was less clear how companies are promoting an industry-wide offset regime.

Despite the obvious liability presented by mining tailings ponds, there is little clarity about financial provision for their reclamation. Not all operators include tailings ponds within their asset retirement obligation (ARO) reporting, and none were willing to disclose the reclamation cost estimates that underlie the tailings pond portion of their ARO calculations.

Given the need to tackle significant environmental and social impacts, evidence of sectoral weakness in strategy and capacity for change is perhaps the most worrying finding. On a positive note, most companies claim to be using carbon costing scenarios to evaluate the viability of projects. But less than a quarter of the companies report the existence of a dedicated committee of senior management responsible for enterprise risk management. Industry claims that technology can overcome environmental impacts of the oil sands, and companies are indeed involved in a wide range of research initiatives and pilot projects of technologies with potential to reduce risk. But research intensity (research spending as a percentage of revenues) is extremely low across the sector. Disclosure on research spending is patchy, but with the exception of Total none of the companies appeared to meet the energy sector average of 0.75% research intensity over the past three years.

The results of the benchmarking exercise are not reassuring. Before investors can get a true picture of oil sands risk, many companies will need to improve their public disclosure significantly. Some operators appear to be lagging in all areas – or if they are not lagging, they are not telling. Companies with plans to enter or go deeper into the oil sands need to show that they – and their prospective project partners—can mitigate the same risks against which we assessed current operators.

Over time, oil sands operators have reduced impacts per barrel of oil, but the expanding scale of the industry means that absolute impacts have continued to increase. Alberta does not have a strong tradition of planning and regulating oil sands development. In a context of mega-projects with high development costs and long investment horizons, a continuing lack of policy clarity could contribute to risk across the entire sector.

In the earlier Ethical Funds report *Unconventional Risks*, companies were called upon to suspend new oil sands development pending completion of integrated land use planning, and to accelerate application of technologies that could improve project environmental and social performance and reduce portfolio risk. We believe this call remains relevant a year later. Although we have not yet seen a return to the boom conditions that prevailed in the oil sands up to 2008, the effective moratorium on new development brought about by the financial crisis appears to be over. Engagement by responsible investors is therefore necessary and timely.

We will be looking to oil sands companies to:

- Openly acknowledge oil sands risks in their public disclosures;
- Include in public disclosure material information on ESG strategy, performance and risk mitigation systems;
- Improve operational performance in areas of environmental and social risk;
- Increase research and investment into technology to reduce environmental and social impacts;
- Make constructive contributions to oil sands-related policy debate and stakeholder processes;
- Engage in constructive dialogue with concerned shareholders.

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