Proposal for Responsible Energy Investment

November 4, 2013

Fossil Free Yale

In the past few weeks, the Yale Advisory Committee on Investor Responsibility has begun considering the following proposal that asks companies to report relevant ESG metrics (ESG stands for Environmental, Social, and Governance). The committee asked select members of the Yale faculty to review the metrics described in this proposal. Other metrics are also under consideration.

It is our hope that this report may be useful to other students and investors thinking about how to address the social harm caused by climate change. This excerpt is from our longer report, which explains the logic that led us to the following proposal.

This proposal regarding fossil fuel investments is written within the framework of The Ethical Investor, the guidebook for Yale's responsible investment policies. The Ethical Investor requires that all options to redress the "social injury" be exhausted before divestment.

The Ethical Investor can be found here: http://acir.yale.edu/pdf/EthicalInvestor.pdf

For questions, please contact FossilFreeYale@gmail.com, or any of the authors of the full report (first.last@yale.edu).

Introduction

While not the only method for responsibly addressing fossil fuel investments, we submit this proposal as a reasonable pathway to address the grave social injury of the fossil fuel industry. In the following document, we have outlined a procedure while explaining the reasoning behind each step.

As Yale's ultimate goal is to reduce participation in grave social injury, not just punish companies, this procedure identifies a set of metrics to identify and engage with the worst performers, and to allow for continued investment or reinvestment in companies if practices improve.

Although we demonstrated earlier in this report that shareholder resolutions do not seem to be particularly effective in the case of fossil fuel industry emissions reductions, it is important for Yale to communicate with the company before taking further action. Furthermore, it is necessary for the company to communicate with Yale and its other shareholders about its practices before work can be done to improve those practices. For these reasons, the first section of the proposal focuses on communication, which we have suggested may be appropriately pursued, consistent with past practice, through writing a letter. In order to make sure this action does not fall into the traps that shareholder resolutions may face, we have tried to make sure this procedure could not be derailed by slow or overly weak responses, remaining consistent with the urgency demanded by the situation.

A large portion of the Carbon Tracker 200 companies do not disclose the data that describes their full impact. For those companies that do not disclose data, the first step of this proposal begins with opening communication about transparency and performance. We, as much as anyone, want Yale to be able to work with the companies to improve their impact on climate change and transition to cleaner fuels. If the company refuses to disclose emissions data, however, it is hard to take seriously any stated intent to improve emissions.

Though throughout the report we have noted that divestment is unlikely to have an impact on the companies' short-term profits and therefore individual company action, public companies have to be responsive to shareholders. The standards determined by the proposal set an attainable target for company improvement and provide the incentive of retaining Yale's investments. Unconditional divestment does not incentivize individual company improvement like the following proposal does. This proposed procedure aims to make use of the any potential that leveraging one's investments might have at creating incentives for ethical behavior.

With any actionable plan, some cutoff lines and timeframes must be employed, and specific lines and dates can seem arbitrary. Indecision as to these specifics, however, should not prevent action altogether. We have chosen timeframe and cutoff numbers to be as reasonable and straightforward as we think possible. To present this proposal as forthrightly as possible, and to underline our intention to work constructively with the Committee to redress a shared problem, we have bracketed these numbers and dates, to distinguish them as variables that the investments office must help to fill in.

Additionally, the bracketed numbers and dates serve to meet the capability condition of divestment. Because we do not have access to the specifics of Yale's investment portfolio, we cannot determine what level of exit may harm the vitality of the endowment, thus we leave the exact cutoff lines to the discretion of the investments office.

Proposal for Responsible Energy Investment

Presented to the Yale Advisory Committee On Investor Responsibility (ACIR)

This proposal outlines a procedure to determine the ethical standing of energy investments, and to engage with companies that do not meet Yale's ethical investing standards. By applying this procedure, Yale can come to a conclusion on the ethical standing of particular companies, and then take appropriate action regarding those companies for Yale's direct holdings, and Yale's indirect holdings through fund managers. Many fund managers are willing to establish Separately Managed Accounts for large institutional investors to tailor investment strategies - for firms that offer this or similar services, due diligence obliges Yale to request negative screening for the socially irresponsible companies identified through the procedure.

Sections:

I. Companies to Consider

For a company to receive consideration, it must be creating grave social injury. For this reason, considered companies must be among the largest contributors to climate change through greenhouse gas emissions. The 2011 Carbon Tracker Initiative report, Unburnable Carbon, identified the 100 coal and 100 oil and gas companies with the largest total carbon reserves. This list of 200 companies is the most complete list of top carbon reserves currently available; Yale should use the following procedures to evaluate and engage with those 200. If new information becomes available, Yale may decide that the list of 200 does not sufficiently address the social injury of climate change and may alter the scope of considered companies.

II. Emissions Metrics

Purpose: To gauge the social harms from the firms, Yale must use some metrics. Without relevant data, Yale has little way to evaluate whether a company is producing more or less social injury than its peers. Failure to disclose this data obstructs efforts to redress these social harms, thus is itself a social injury.

Methodology (relevant indicators): A large set of company-specific environmental data is available for reporting. Among the indicators reported, the most relevant data points are those relating to greenhouse gas emissions. There are three categories of greenhouse gas emissions that are reported: Scope 1, Scope 2, and Scope 3.

Greenhouse Gas Emissions, Scope 1: As defined by The Carbon Disclosure Project, Scope 1 greenhouse gas emissions measure "direct emissions from GHG sources owned or controlled by the reporting organization." These emissions come from company operations such as fossil fuel extraction.

Greenhouse Gas Emissions, Scope 2: The Carbon Disclosure Project defines Scope 2 greenhouse gas as "Emissions that do not physically occur from within the organization's reporting boundary and are therefore 'indirect' emissions. Scope 2 emissions are caused by the organization's consumption of electricity, heat, cooling or steam brought into its reporting boundary. This category is often called 'purchased electricity' because it represents the most common source of Scope 2 emissions."

Greenhouse Gas Emissions, Scope 3: Greenhouse Gas Emissions Scope 3, includes all downstream emissions. The Carbon Disclosure Project defines GHG Scope 3 as "An organization's indirect emissions other than those covered in Scope 2. They are from sources that are not owned or controlled by an organization, but which occur as a result of its activities. The Scope 3 emissions subcategories considered by the CDP Supply Chain Information Request are: (1) business travel emissions, (2) distribution and logistics emissions, (3) emissions from the use and disposal of a company's products, (4) supply chain emissions."

Greenhouse Gas Emissions Scope 1, Scope 2, and Scope 3, per unit of energy produced (BOE): The sum of Scope 1, 2, and 3 emissions represents the GHG emissions a company causes, which determines total contributions to the social harm of climate change. This number can be compared to the total units of energy produced, already reported by companies in units of barrel of oil equivalents (BOE) to find the emissions intensity of each company. As certain types of energy extraction and consumption are more injurious to the climate than others, this data can provide Yale information on the comparative harm caused by practices across the industry, allowing Yale to identify the most grievous offenders.

Methodology (accessing information): All information on relevant indicators can be found on the Bloomberg Terminal in the CSSSI library at Yale University. Though it is not the only database that companies may report relevant environmental information to, Bloomberg is comparable to other rating systems. Bloomberg uses climate data from the Carbon Disclosure Project (CDP) and the Global Reporting Initiative (GRI). These reporting agencies verify data through independent, third-party consultants.

III. Reporting Emissions Data

Purpose: Communicating with management is among the first steps of engagement outlined in The Ethical Investor. Yale's first step regarding companies on the Carbon Tracker list of 200 is to write a letter to companies to communicate Yale's position.

Nonreporting Firms

For those companies on the list of 200 that do not report greenhouse gas emissions, Yale must write a letter to the company communicating its desire for the company to disclose the relevant metrics [within one quarter] by reporting the information to the Carbon Disclosure Project, or another reputable reporting agency.

Action Steps:

If, after the initial [one business quarter], the company has not voluntarily reported the required information, indicating it does not intend to redress the social injury it causes, Yale should give it notice of intent to divest over the course of [two years]. [Three weeks] prior to the end of the initial quarter, Yale may send a notice to the company reminding it of Yale's intent to divest its shares if the company cannot address Yale's concerns as an ethical investor.

To eliminate the risk associated with being forced to sell a stock at a relative low price, if a company indicates it will not report emissions data or fails to respond to Yale's request, and Yale must resort to divestiture, Yale will have [two years] to sell all of its shares in the company.

IV. Engagement With Firms that Report

Purpose: In order to identify the worst contributors to the social harms of climate change, Yale should assess each company's performance relative to the industry.

Methodology (relevant indicators): The company's emissions ratio per unit of energy (Sum of Scopes 1, 2, and 3 of GHG emissions, per BOE produced) is important to determine relative social injury caused by fossil fuel companies since it is the most quantifiable among the relevant indicators to report.

Methodology (accessing information): All information on relevant indicators can be found on the Bloomberg terminal in the CSSSI library. Though it is not the only database that companies may report relevant environmental information to, Bloomberg uses CDP (Carbon Disclosure Project) data, among other data, and is comparable to other rating systems.

For the [top three quartiles] of Reporting Companies

Companies which are not among the worst (highest emissions ratio) contributors to climate change in their industry are not contributing the most to grave social injury, and as such merit continued investment.

For the bottom [quartile] of reporting companies:

If a company on the list of 200 has an emissions ratio in the bottom [quartile] of reporting companies, (the bottom quartile comprises the companies with the highest magnitude ratios, in other words, the worst emitters), Yale must write a letter to the company communicating its desire for the company to implement a plan to take the company out of the bottom quartile of reporting companies within [two years].

If the company does not adhere to its [annual] goals for reductions in emissions intensity, or does not formulate goals for doing so, it is demonstrating it does not intend to correct the grave social injury it causes, and Yale would be obligated to divest its holdings as a last resort over [two years].

Purpose: If a company creates a grave social injury and the company does not quickly show a commitment to changing its internal practices, then according to The Ethical Investor Yale must exit the company through divestment to avoid participation in social injury.

If the company refuses to engage in efforts to redress its social harms, Yale cannot expect the company to improve through shareholder resolutions. Evidence provided earlier in this report and in The Ethical Investor highlights the futility of shareholder resolutions. Resolutions capable of passing are usually too weak to create significant company change. Timetables for action from shareholder resolutions are unlikely to be short enough to have a significant impact due to the urgency of climate change.

Action Steps:

If, after the initial [one business quarter], the company has not voluntarily implemented a plan to improve emissions, Yale divests from the company over the course of the next [two years]. [Three weeks] prior to the end of the initial quarter, Yale may send a notice to the company reminding it of Yale's intent to divest its shares if the company cannot address Yale's concerns as an ethical investor. To eliminate the risk associated with being forced to sell a stock at a relative low price, once deciding that investments in a company are unethical and divestment is the best option, Yale will have [two years] to sell all of its shares in the company.

V. Re-evaluation

Yale would, every [two years], reevaluate the standing of each of the largest 100 oil & gas and the largest 100 coal companies (sized by carbon reserves) according to this proposal. If, upon reevaluation, a company from which Yale has divested has improved to meet the above criteria for investment, Yale may reinvest in the company.

VI. Amendment Proceedings:

As the the dynamics of climate change and public response are changing, it is to be noted that the procedure outlined in this report may be publicly amended. If at any time the ACIR determines that fossil fuel companies no longer cause grave social injury, or that fossil fuel companies contribute to more social harm than what was presented in this report, the ACIR may publicly amend the proposal after consulting with Yale faculty and independent climate scientists. After announcing intention to amend the proposal, the ACIR would then hold several open meetings over [one academic year] to bring the reasons for amendment to light within the Yale community, and solicit the Yale community's input before finalizing the amendment.

Appendix: Flowchart