

20. Fossil Fuels and Ethical Investment

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Status of Paper	Final
Action Required	Decision
Resolution	20/1. The Conference receives the Report.

Summary of Content and Impact

Subject and Aims	This report is written in response to Memorials received by the 2014 Conference which requested a review of the climate change policy of the Central Finance Board with specific regard to investment in fossil fuels. It aims to update the Conference on progress and outline the advice given on fossil fuels and ethical investment by the Joint Advisory Committee on the Ethics of Investment.
Main Points	<ul style="list-style-type: none"> • recent advice and decisions on energy issues • current issues around energy and fuels • principles for investment related to fuels to be based on: <ul style="list-style-type: none"> ○ an expectation that companies will reduce their absolute emissions and emissions intensity, and that of their supply chain ○ decisions on exclusion or disinvestment will have: a focus on fuels that are most carbon intensive; a focus on a company's future investment plans; a focus on whether a company envisages "business as usual" ○ seeking investments that contribute to or facilitate reductions in greenhouse gas emission • This policy focuses initially on the most polluting forms of energy, whilst engaging with companies to encourage them to reduce their emissions and plan for a low carbon future.
Background Context and Relevant Documents (with function)	Hope in God's Future, Statement of the Conference, 2011 Central Finance Board position papers and policy statements on climate change and electricity generation Memorials M38-43 and replies, 2014 Conference
Consultations	Joint Advisory Committee on the Ethics of Investment (JACEI) Ecumenical partners via the Church Investors Group Correspondence with Methodist members
Impact	Impact on the advice given by the JACEI to the Central Finance Board. Exclusions on companies eligible for investment can have an impact on the financial performance of the investment portfolio.

20. Fossil Fuels and Ethical Investment

1. Executive summary

- 1.1 The Joint Advisory Committee on the Ethics of Investment (JACEI) is the body established by the Conference to offer advice to the Central Finance Board (CFB) on ethical aspects of investment. The CFB is responsible for managing investments for the Methodist Church, including for the Ministers and Lay Employees Pension Schemes. JACEI has worked with the CFB to develop policies on investment and climate change for some years. As a result, since 2011, the CFB has been implementing a climate change policy, which includes an aim to reduce the carbon footprint of the equity portfolio. Since early 2014 the CFB has also applied a policy that considers the carbon emissions intensity of electricity power generation companies and their future investment plans in this respect. This has led to some companies being excluded from investment.
- 1.2 Over the past year JACEI has worked with the CFB to produce a further policy on climate change focused on the implications of different fuels. It indicates that companies which make significant investments in extracting fuels with the heaviest emissions, such as thermal coal, raise serious ethical concerns. The options open to the CFB with regard to such companies include intense engagement, co-filing shareholder resolutions and, ultimately, divestment.
- 1.3 The next step is for JACEI to advise the CFB as it works to implement this policy. At the same time, JACEI expects to revisit the original climate change investment policy over the course of the year to ensure it remains up to date. It continues to welcome the views of church members as it undertakes this work.

2. Introduction

- 2.1 The 2014 Conference considered six Memorials (M38 – 43) relating to Methodist money invested in fossil fuels. As a result it directed the Methodist Council to ensure that the Joint Advisory Committee on the Ethics of Investment (JACEI):

undertake a review of the CFB climate change policy with specific reference to the oil, gas and coal extraction sectors and to provide the 2015 Conference with an update on progress. This review should include consideration of the ethical issues related to investment in coal, oil and gas extraction companies and investment in clean, renewable energy and other low-carbon technologies.

JACEI, the Methodist pension funds and the Connexional Team have also received letters from Methodists supporting the campaign to disinvest from fossil fuels. Over the last year JACEI has worked with the CFB to develop a position paper on the ethical implications for different fuels.¹

- 2.2 This report is, in response to the Memorials, an update on the progress of the work undertaken so far.

¹ The position paper will be available in advance of the Conference on the CFB website at www.cfbmethodistchurch.org.uk/ethics/

3. Taking ethical investment seriously

- 3.1 Methodism takes the ethical use of its money seriously. The CFB invests £1.1 billion of Methodist assets. Its challenge is to make good financial returns, whilst being consistent with the ethical positions adopted by the Methodist Church. It has policies on a range of ethical issues including human rights, climate change, the military, gambling and alcohol.
- 3.2 CFB seeks to be an active investor and will use engagement to bring about change within companies. Holding shares in a company gives CFB the right to ask questions about a company's performance, about its priorities and plans, about how it meets international standards and about its disclosures. Not only does the CFB actively exercise this right, but it also uses its votes at company AGMs to record its views on issues such as executive remuneration, as well as 'co-filing' resolutions with other active shareholders on ethical issues. However there are some companies whose business is so contrary to Christian principles and the Methodist position that a decision is taken not to invest. Secondly, if there are serious ethical concerns and a company repeatedly refuses to engage with the CFB or address these concerns, then the CFB, advised by JACEI, will move towards disinvestment. However once CFB is no longer a shareholder, its engagement will cease and the prospect of the Methodist Church influencing the company any further is much diminished. Disinvestment, therefore, is not a decision which is taken lightly.
- 3.3 The investor role is separate from the advisory role. JACEI was established by the Methodist Conference in 1983 and is made up of members nominated by the Methodist Council and the CFB. Its role is to advise the CFB of ethical considerations relating to investment and to report to the Conference on whether the CFB is managing funds according to an ethical stance which is consistent with the aims of the Methodist Church. JACEI can only offer advice; ultimately, investment decisions are the legal responsibility of the CFB.
- 3.4 It is important to hold onto this distinction between investment decisions and ethical advice in the way the Methodist Church manages its money. For example there has been recent coverage of campaigns urging divestment from 'risky' assets such as coal. Research has suggested that the vast majority of coal reserves must remain underground and unburned if temperature increases are to be kept below two degrees.² The argument is that, if governments take climate change more seriously and price out the use of fossil fuels, then investors may be left with 'stranded assets' – assets which cannot be used and are therefore worthless. Whilst such decisions are important, these are ultimately *financial* decisions which are the responsibility of the CFB. JACEI's role is to advise on the ethical issues around climate change which are different but just as challenging.

4. Hope in God's Future – putting the Methodist Church's climate change policy into practice

- 4.1 Our world faces irreversible and potentially catastrophic changes to the climate. These changes are a result of human activity which has emitted greenhouse gases. Climate change is already linked to more extreme weather events. While this will affect us all the most severe impacts are likely to fall on the poorest who also have fewer resources available to adapt. Avoiding the most catastrophic climate change will necessitate a change in the way we live our lives – our current lifestyles are not sustainable. However this requires more than individual action. We need binding international agreements, collaboration and regulation,

² At the December 2009 Copenhagen Summit Governments agreed to take whatever political action necessary to restrict global warming to below 2 degrees.

and a change to the way we structure our economies. While avoiding the use of fossil fuels may ultimately be necessary, we need to recognise that this will take time and the cleaner fossil fuels will play an important part in the transition.

- 4.2 Methodists have been putting their concerns about climate change into practice for many years now. *Hope in God's Future* was adopted as a statement of the Methodist Conference in 2011, and is the main body of Methodist witness on climate change. It outlines the theological underpinnings of a Christian approach to climate change.

"In encountering the biblical warnings about the consequences of failing to love and deal justly with those in need, it is hard to escape the conclusion that in continuing to emit carbon at rates that threaten our neighbours, present and future, human and other than human, we are bringing God's judgement upon us. Even there we should not despair: that God judges rather than abandons us is a sign of God's grace and continuing love for us."

- 4.3 The report also makes recommendation both for action by the Church and its members and, following the Conference decision to adopt *Hope in God's Future*, the Methodist Church has been making efforts to reduce its own carbon footprint.³ The report also calls for the continuing prophetic witness of the Church on the subject. At the moment this is focused on the climate summit in Paris in December 2015, as binding international agreements will be crucial to reducing emissions globally.⁴

- 4.4 *Hope in God's Future* did not make any specific reference to fossil fuels. However it did note the recommendations of the UK Government's Committee on Climate Change that to avoid the worst impact of climate change:

- global emissions should be cut to 50% of their current level by 2050
- and for the UK this will imply an 80% cut in greenhouse gas emissions from 1990 levels by 2050

The report notes the consequence of this is that *"Church policy in many areas, including the investment of church funds, will need to be reviewed in the light of this commitment"*.

5. Recent JACEI advice and CFB decisions on energy

Below are details of three CFB policies, developed with the advice of JACEI, which are relevant to the question of fossil fuels:

5.1 Climate Change Policy

In the light of the 2011 Conference statement, the CFB adopted a Climate Change Policy. It covered the following areas:

- All companies should disclose and reduce their emissions. This applies to all industries, but is of particular importance to those with a high level of carbon intensity. JACEI has supported CFB's work as part of the Carbon Disclosure Project working to encourage and persuade companies who fail to engage with a process to disclose their carbon emissions. This project has been successful and more UK-listed companies are now committed to such reporting.
- The CFB should have a portfolio with a measurably declining and relatively low carbon footprint. Each year since, the CFB has used two external consultancy services to assess the carbon footprint of its UK equity portfolio employing distinctly different

³ In recent years, for example, around 85 Methodist churches have installed solar power systems on church roofs, and new manses should have a minimum "C" energy performance certificate.

⁴ www.jointpublicissues.org.uk/issues/environment/pray-and-fast/

methodologies. These have confirmed that the CFB portfolio has a smaller carbon footprint than that of a benchmark of UK listed companies.

- The evaluation of companies should consider the emissions of a company's supply chain as well as emissions involved in the use of a company's product.

5.2 **Electricity Generation Industry**

An extension to the Climate Change policy was developed to cover the industrial sector that is the largest emitter in developed economies – the electricity generation industry. This noted the need for companies to reduce their absolute emissions and emissions intensity, and that commissioning new coal-fired power plants in developed economies was unlikely to be consistent with the goal of reducing emissions by 80% in the UK and 50% globally. As a result, Drax and RWE were considered unacceptable for investment, and the investment in RWE was sold (no investment in Drax was held). In addition engagement was carried out with Centrica, E.ON and SSE.

5.3 **Extractive Industries**

JACEI has previously given advice on the extractive industries, though most of this has related to local environmental impact, human rights and governance, rather than ethical issues regarding the use of what is extracted. The current policy is that companies must be 'best in class' in these areas in order to be acceptable for investment. As result only extractive companies that have been specifically assessed as being best in class are held within the portfolio or judged suitable for investment.

6. **Energy and fuels – some current issues**

The market for energy is a mix of global and local markets with some fuels being traded widely and internationally and others not. The oil, gas and coal companies listed in the UK have the majority of their operations overseas. It is therefore impossible to consider the UK in isolation. CO₂ released by burning fossil fuels accounted for an estimated 65% of global greenhouse gas emissions in 2010.⁵ An even larger proportion of the UK's greenhouse gas emissions come from fossil fuels for the production of energy (eg for electricity, transport, heating, industrial purposes).⁶ Since 1990, the UK has significantly developed its gas infrastructure placing less reliance on coal for electricity generation. In 2012 power sector emissions accounted for 27% of UK emissions covered by carbon budgets.⁷

6.1 **Fuels and the economy**

The vast majority of greenhouse gas emissions emanating from fossil fuels relate to their use rather than their extraction. It is impossible to separate the production of energy from its use. The harnessing of energy (from whatever source) lies at the centre of the economic system. Many industries – and therefore much of the economy – are heavily reliant on fossil fuels as an energy source. The need to decarbonise the energy sector has considerable implications for industries which rely on transport, cement, building products, glass and steel. Huge sectors of the economy will need to adapt to new fuel sources. This process needs to happen with greater urgency, but it will not happen overnight.

The economic implications of using fossil fuels vary significantly between regions and nations. It is widely acknowledged that developing nations are likely to suffer significantly from the impacts of climate change, while not being the major contributors to emissions. At the same

⁵ Fifth Assessment report of the Intergovernmental Panel on Climate Change (IPCC), www.ipcc.ch/

⁶ UK Government Committee on Climate Change

⁷ www.theccc.org.uk/wp-content/uploads/2013/12/1785b-CCC_TechRep_Singles_Book_1.pdf

time, there are concerns that restrictions on using fossil fuels can have the effect of reinforcing economic inequality between nations and preventing developing economies from accessing low cost energy. It is important that any ethical policy concerning fossil fuels takes into account issues relating to justice between nations and appropriate sourcing of finance to develop alternative low-carbon economies.

6.2 Carbon Capture and Storage (CCS)

CCS technology would capture CO₂ emissions and store them underground to prevent them being released into the atmosphere. Some hope is placed in the potential for this technology to limit carbon emissions. However despite significant investment, the commercial application of this technology is still in its infancy, and significant challenges to its wide scale adoption remain. Future climate change policies must not rely on CCS being introduced soon and at a sufficient scale.

6.3 Other uses of fossil fuels

Fossil fuels are not solely used for energy. The two principal uses are for metallurgical coal⁸ in the steel making process, and oil and natural gas derivatives as raw material for the production of plastics or other products ranging from paints, construction materials and pharmaceuticals. There are not currently commercial-scale means of replicating processes for producing plastics without fossil fuels. A transition to a low-carbon economy that is less reliant on fossil fuel extraction needs to take into account the impact on many industries and products on which our society depends.

7. Different types of fuels

7.1 All fuels have ethical advantages and disadvantages with respect to the impact on the local environment, including on water resources, human rights and health and safety concerns. This paper is focused on one ethical dimension - the climate change implications of fuels - though when making investment decisions about companies all the ethical concerns regarding their activities will be considered. It is clear that fossil fuels cannot be seen as an homogenous group even when considering just their climate change implications. It is also worth noting that in many countries oil, gas and coal compete for government subsidies alongside renewable energy and there is often a disconnect between climate change policies and energy policies.

Primary energy mix globally in 2013⁹

Oil	32.9%
Coal	30.1%
Natural Gas	23.7%
Hydroelectricity	6.7%
Nuclear	4.4%
Other renewables	2.2%

Primary energy mix in the UK in 2013¹⁰

Natural gas	34.2%
Oil	34.1%

⁸ Metallurgical coal has a different chemical composition from thermal coal and tends to trade at a premium to thermal coal. As a result it is rarely used for other purposes, and so can be considered as functionally different to thermal coal.

⁹ BP Statistical Review of World Energy

¹⁰ Digest of UK Energy Statistics

Coal	18.3%
Nuclear	5.3%
Bioenergy	4.1%
Renewables	4.0%

Emissions per unit of energy produced

Thermal Coal	94kg CO ² /GJ
Oil	78 kg CO ² /GJ
Natural Gas	56 kg CO ² /GJ
Biofuels	variable
nuclear	low
renewables	variable and low

- **Thermal coal** – Thermal coal is principally used to generate electricity and heat. It is the most emissions-intensive of the major fossil fuels¹¹, with lignite (a low grade coal) having even higher emissions
- **Oil** – Oil is widely used as a transport fuel, in the chemicals industry and as a lubricant. It is no longer widely used to generate electricity.¹² There are currently few commercially viable alternatives to oil for most forms of transport. The emissions embedded in the extraction of oil should be considered as well as those involved in its combustion. Oil recovered from tar sands (or oil sands) has an estimated emissions intensity 20-25% greater than conventional oil.¹³
- **Natural gas** – natural gas is principally used to generate electricity and heat, though it is also used in the chemicals industry. Over recent years the extraction of shale gas through the process of “fracking” has become controversial. This is due in large part to the impact on local communities rather than the emissions intensities,¹⁴ as significant methane emissions are not inherent in the process.
- **Biofuels** – Biofuels encompass a wide variety of fuels. They are typically carbon-based, but differ from fossil fuels in that the carbon is first absorbed from the current atmosphere (eg through growing crops or trees) before combustion. Some biofuels such as willow are used as a primary energy source while others such as sugar beet are converted into ethanol and are used as fuel for transport. The term is often also used for methane from landfill sites or anaerobic digestion of organic waste. Biofuels are not without controversy. Supporters argue that the net greenhouse emissions from biofuels are significantly lower than for fossil fuels. However, opponents note that the land from which biofuels are harvested would probably have been covered with vegetation and absorbed a similar amount of carbon irrespective of whether that vegetation was subsequently burnt or converted for energy. There are further ethical concerns arising from large-scale biofuel production including implications for food security in some developing countries.
- **Nuclear** – Nuclear energy has the advantage of having relatively low carbon emissions per unit of energy (although when life cycle emissions are taken into account this is not as low as

¹¹ The greater carbon intensity relates to a larger proportion of carbon within the chemical composition of coal compared with other fossil fuels, with an average emissions intensity per unit of energy being 94kg CO₂/GJ. This is then compounded by the lower thermal efficiency typically exhibited by coal-fired plant resulting in much higher emissions than for other fossil fuels.

¹² Eg BP Energy Outlook 2035

¹³ www.trucost.com/published-research/33/sector-briefing-oil-sands-exposure-to-energy-and-carbon-costs

¹⁴ The Committee on Climate Change offer an analysis of the emissions from Shale Gas, see www.theccc.org.uk/wp-content/uploads/2013/09/Shale-gas-blog-final.pdf

is often claimed).¹⁵ However there are significant ethical concerns other than climate change. The low, but real, risk of catastrophic incidents such as Chernobyl or Fukushima Daiichi, and the safety management of nuclear power plants, are matters of concern, as are the systems in place for the storage of radioactive waste for tens of thousands of years.¹⁶

- **Renewables** - Renewable energy sources tend to have very low emissions per unit of energy, with the emissions being primarily those embedded in the construction process. As with nuclear, it is difficult to deliver renewable energy in forms other than electricity. Some sources (eg wind and solar) are more intermittent than others (hydro or geothermal). There are concerns regarding local environmental impacts from some renewable sources of energy such as wind.

8. Emerging ethical position on fossil fuels

8.1 In the report *Hope in God's Future* the Methodist Conference made clear its support for the UK government's target of an 80% cut in CO² emissions by 2050 from 1990 levels which, when the UK Climate Change Act was passed, was considered to be the UK's share of the global effort to limit warming to two degrees.¹⁷ Yet as individuals, and our economy as a whole, we are still dependent on energy from fossil fuels (and indeed on the chemicals they provide), even if we commit ourselves to transition to a lower carbon future. Whilst recognising this, those such as Operation Noah and the Bright Now campaign, who urge the Church to disinvest from fossil fuels, argue that the Church should no longer profit from corporate interests which are bringing about dangerous levels of climate change.

8.2 Yet in *Hope in God's Future*, the Methodist Church did not take a stance regarding any fuels as being *per se* any more or less ethical; it is the greenhouse gas emissions inherent in the present and future use of the fuels, as well as any local environmental or human rights concerns regarding their extraction or use, that determine the acceptability of a given fuel.

8.3 JACEI has therefore developed ethical advice for the CFB which puts the need significantly to reduce carbon emissions at the heart of its climate change policy, but which recognises the complexity of the challenges we face. Coal and tar sands oil are the worst performing fossil fuels in terms of emissions and should be the priorities for disinvestment by the CFB. Other forms of fossil fuels are likely to become unacceptable as the need for increased emission reduction continues. In the meantime, JACEI has encouraged the CFB to continue to engage with companies to encourage them to reduce their emissions and plan for a low carbon future, and to reduce the carbon footprint of its own portfolio.

8.4 The advice on fossil fuels offered to CFB by JACEI is based on the principles below:

- Companies should reduce both their absolute emissions and the emissions intensity of their own operations. In addition, there should be an expectation that companies would reduce emissions arising from their supply chains and the use of their products, where possible.
- Investment decisions will take the following into account:

¹⁵ WCC Statement towards a nuclear free world (Footnote xiv)

www.oikoumene.org/en/resources/documents/central-committee/geneva-2014/statement-towards-a-nuclear-free-world#_edn14

¹⁶ It is worth noting that neither the Methodist Church nor JACEI have done any work on the ethics of nuclear energy or the nuclear industry for more than 15 years.

¹⁷ www.theccc.org.uk/tackling-climate-change/the-science-of-climate-change/setting-a-target-for-emission-reduction/

- It is unlikely that companies where a significant proportion of revenues or profits are derived from thermal coal or tar sands would fit into a portfolio with a relatively low and measurably declining carbon footprint. Over the course of time it is likely that other fossil fuels will fall into the same category for many of their current uses.
- The focus of investment analysis should be on the investment plans and future trajectory of a company's emissions and those of its products. How does it view the future and its place within it? Companies with investment plans which have a significant proportion devoted to increasing oil sands or thermal coal production would not be behaving in a manner consistent with the need to reduce global emissions by 50% by 2050.
- Companies whose plans are predicated on a 'business as usual' approach are likely to be viewed as not taking the issue seriously.
- CFB would be encouraged to seek investments that contribute to or facilitate reductions in greenhouse gas emissions.
- Companies that specialise in the technical aspects of exploration or extraction should be given attention alongside companies that commission exploration.
- It is nationally enforced regulation on a global scale that is most likely to result in the reduction of emissions. Corporate lobbying by companies or through industry groups in support of measures or investments that would not be compatible with the effort required to limit warming to two degrees would be a significant concern which would warrant serious engagement.

9. Conclusion

- 9.1 The judgement of JACEI, in line with many other concerned investors, is that an appropriate investor response should concentrate on intense engagement with companies with the ultimate option of divestment. The JACEI advice developed over the past year focuses initially on the most polluting forms of energy, whilst engaging with companies to encourage them to reduce their emissions and actively to promote and plan for a low carbon future.
- 9.2 After considering advice from JACEI, CFB develops a policy upon which it can base investment decisions. The JACEI advice on specific fuels should be regularly reviewed against internationally agreed action that is considered necessary to limit global warming to two degrees and in due course prioritise other fossil fuels as necessary.
- 9.3 This approach represents an important step on a journey but must be seen as one of a number of actions taken by the Methodist Church in response to climate change. JACEI hopes to hold a roundtable in the autumn of this year with a number of stakeholders, including those who have been active in calling for action on fossil fuels, as it considers implementing its climate change policy for ethical investment.

***RESOLUTION

20/1. The Conference received the Report.