



**Action Report**

## Environment (Climate Change)

### Devon Energy

May 18, 2017

Ticker	Exchange	Meeting Date	Record Date	Annual Meeting Location
DVN	NYSE	6-7-2017	4-10-2017	Oklahoma City, Oklahoma

Agenda	
Item	Proposal
1	MGT: Elect directors
2	MGT: Advisory vote on the frequency of future advisory votes on executive compensation
3	MGT: Advisory vote on executive compensation
4	MGT: Ratify selection of auditors
5	MGT: Approve Annual Incentive Compensation Plan
6	MGT: Approve 2017 Long-Term Incentive Plan
7	SH: Review/report on climate change advocacy
<b>8</b>	<b>SH: Report on climate change</b>
9	SH: Report on lobbying
10	SH: Link executive pay to sustainability metrics

**Si2 Briefing**                      [Environment \(Climate Change\)](#)

**Report Author**                [Sara E. Murphy](#)

**Links**                              [2017 Proxy Statement](#); [2016 Form 10-K](#); [2016 Corporate Responsibility Report](#)

**Resolved Clause**              Resolved: Shareholders request that beginning in 2018, with board oversight, Devon publish an annual assessment of the long-term portfolio impacts of global climate change policies, at reasonable cost and omitting proprietary information. The report should analyze the impacts on Devon’s portfolio of oil and gas reserves and resources in a scenario in which reduction in demand results from technological innovation, carbon restrictions and related rules or commitments adopted by governments consistent with the globally agreed upon 2 degree target. The report should assess the resilience of the company’s full portfolio of reserves and resources through 2040 and beyond and address the range of financial risks associated with such a scenario.

**Lead Proponent**                George Gund Foundation

**Vote History**                    A similar proposal in 2016 earned 36.1 percent support, and another in 2015 earned 23.2 percent. This year’s resolution has seen significant support among shareholders of oil and gas companies, earning 40.8 support at **Marathon Petroleum** and more than 50 percent support at **Occidental Petroleum**, the first time it has earned a majority vote. The resolution is also seeing near-majority votes at electric utilities this year, and earned majority support at **PPL**, another industry first.

**Summary**

Devon Energy is among the largest U.S. independent oil and natural gas exploration and production companies, and is increasing its oil assets. The proponent is concerned that changing public policy on climate change that seeks to reduce global emissions will threaten Devon Energy's long-term viability. It wants the company to review and report annually on how such changes will affect its oil and gas reserves and identify related risks, essentially requesting a stranded carbon asset risk analysis. Management opposes the resolution, asserting that climate change risk-related information is already available and that the requested report would be "costly, duplicative and likely to include proprietary data and plans." The board says it already discloses climate risk information in its SEC filings and sustainability report. The company currently acknowledges in its public filings that increasing climate change regulations may hurt its business and the valuation of its oil and gas reserves; it does not, however, provide detailed and scenario-based analysis of related risks as the proponent requests. Management asserts that such analysis would be highly speculative.

**I. Devon Energy and Climate Change**

Devon Energy is a leading independent energy company engaged primarily in the exploration, development and production of oil, natural gas and natural gas liquids (NGLs). Its operations are concentrated in

Financials			
(\$ millions)	2015	2016	% Change
<b>Total Revenue</b>	\$13,145	\$12,197	(7.2%)
<b>Net Income</b>	(\$14,454)	(\$3,704)	74.4%

various North American onshore areas in the United States and Canada. The company produces about 1.4 billion cubic feet of natural gas, 116 MBbls of natural gas liquids and 151 MBbls of oil per day and has proved reserves of 2 billion barrels of oil equivalent.

Devon Energy also owns natural gas pipelines, plants and treatment facilities in many of its producing areas, making it one of North America's larger processors of natural gas and NGLs. In addition, the company has doubled its onshore North American oil production since 2011 and states that it has a deep inventory of development opportunities.

Devon pioneered the commercial development of natural gas from shale and coalbed formations, and it is a leader in using steam to produce bitumen from Canadian oil sands. Devon Energy is the first and only U.S.-based independent energy company to develop and operate a bitumen oil sands project in Canada. Canadian heavy oil [represented](#) 22 percent of its production and 24 percent of its proved reserves in 2016.

In 2015, Devon [reported](#) an operating loss of nearly \$21 billion, resulting primarily from commodity price declines. In 2016, Devon continued to [report](#) a multi-billion dollar operating loss of \$2.9 billion. The company notes in its 2016 Form 10-K the extreme oil price volatility that has characterized the last few years, noting this has led to "substantial impairments" to its oil and gas properties. Devon Energy believes this volatility is likely to continue going forward, owing to factors that include "conservation and environmental protection efforts," "adverse weather conditions and natural disasters, such as tornadoes, earthquakes and hurricanes," "the price and availability of alternative fuels," "technological advances affecting energy consumption" and "governmental regulations and taxes." Since 2014, the company has reduced its capital expenditures by about 70 percent.

**Potential Disruptions to the Oil & Gas Industry**

According to the International Energy Agency (IEA), transportation [accounts](#) for more than one-fifth of global carbon dioxide emissions and that percentage is likely to rise, [requiring rapid adoption](#) of new

technologies to keep temperatures within the 2-degree Celsius limit set by the Paris Agreement. The IEA and the International Council on Clean Transportation [forecast](#) that transport electrification will play a critical role in achieving required greenhouse gas reductions by 2050. Sales of electric vehicles (EV) are [on the rise](#): in 2016, U.S. EV sales rose by 37 percent in the United States and 41 percent globally. **Royal Dutch Shell** and **Statoil's** CEOs recently [predicted](#) that oil demand would peak as early as the 2020s with “a shrinking oil industry” as vehicles are electrified. This is consistent with the IEA’s 450 Scenario, in which global action coalesces around a goal of limiting average warming to 2 degrees Celsius. A recent [report](#) from Carbon Tracker and the Grantham Institute calls “business as usual” predictions of slow growth in the market for EVs a “high risk strategy,” and urges use of a range of scenarios to evaluate future demand.

An October 2016 [Fitch Ratings report](#) warned that oil companies faced a “resoundingly negative” threat from the recent and growing proliferation of electric cars. “Widespread adoption of battery-powered vehicles is a serious threat to the oil industry,” says the report, which urges energy companies to plan for “radical change” spurred by new technologies that could arrive more quickly than expected. Ratings agency Moody’s [announced](#) in June 2016 that it would begin analyzing carbon transition risk based on the two-degree scenario. Moody’s noted the particular risk exposure of the energy sector. In February 2017, Moody’s published a [subsequent report](#) asserting that future shifts in U.S. climate policy—which are likely under the new Trump administration—would not stall global emissions reduction efforts.

Increased fuel efficiency for internal combustion engines could reduce demand for gasoline and diesel fuels. According to Obama-era regulations, efficiency requirements for light-duty vehicles are slated to increase to 54.5 miles per gallon by 2025, and agencies under the previous administration had been considering standards leading to significant reductions in fuel consumption for medium and heavy-duty trucks. President Trump has expressed his intention to roll back fuel efficiency standards. At the same time, California has the clout to enforce its own more stringent standards, and has stated its willingness to go up against the new administration. California’s market share is so significant that vehicle manufacturers typically find it more efficient to conform their entire U.S. production to the state’s requirements, rather than to produce separate vehicles for the rest of the country. It remains uncertain how this will play out.

As You Sow published a July 2016 report, *Unconventional Risks: the Growing Uncertainty of Oil Investments*, which considers structural changes in the oil market that have the potential to contribute to a weakening of the oil industry. The report explores the recent prolonged downturn in oil prices, where oil supplies outpaced demand, and underscores the risks associated with investing in complex, high-cost projects such as deep water drilling.

### ***Devon Energy’s Climate Change Disclosure***

In its 2016 Form 10-K, Devon Energy mentions climate change only twice, in both cases to identify laws and regulations to which it is subject, to assert its compliance with the same and to acknowledge the risk of potentially stricter regulation in the future. The same holds for greenhouse gas emissions. It says:

Although it is not possible at this time to predict how legislation or new regulations that may be adopted to address greenhouse gas emissions would impact our business, any such future laws and regulations imposing reporting obligations on, or limiting emissions of greenhouse gases from, our equipment and operations could require us to incur costs to reduce emissions of greenhouse gases associated with our operations. Limitations on greenhouse gas emissions could also adversely affect demand for oil and gas, which could have a material adverse effect on our profitability, financial condition and liquidity.

In its 2017 proxy statement, Devon Energy notes that it is:

required to make specified disclosures about our reserves, and any third party who audits our reserves is required to disclose in its reserves report a discussion of the possible effects of regulation on our ability to recover the estimated reserves. In short, we already address and publicly disclose in our SEC filings the data that would appear in any report sought by the proposal.

The referenced third party is Devon Energy's auditor, LaRouche and Deloitte, which in its 2016 [report](#) to the SEC warned:

future changes in taxation affecting oil and gas producing companies and their products and changes in environmental and administrative regulations may significantly affect the ability of Devon to operate and produce oil and gas at the projected levels. Therefore, volumes of reserves actually recovered and amounts of cash flow actually received may differ significantly from the estimated quantities presented in this audit.

In its 2016 Corporate Social Responsibility Report, Devon Energy offers the following, fairly combative decrrial of regulatory efforts to constrain climate change:

In a strong and growing economy, there's a place for all forms of energy – carbon fuels, wind, solar, nuclear, biomass, hydro and others yet to be developed. Today, we rely primarily on oil and natural gas to fuel the systems of our everyday lives – transportation, heating and cooling, lighting, manufacturing, telecommunications and technology.

Also, many of the products we use every day are made from plastics and compounds derived from oil and natural gas.

And yet, the calls persist to further regulate (or ban outright) oil and natural gas production, as part of a worldwide effort aimed at averting climate change. As we continue to discuss potential regulatory changes for energy production, we must consider the risks of energy shortages and higher costs. Leaving carbon fuels in the ground would necessitate more wind, solar and other forms of energy, but output from these intermittent sources cannot begin to meet the growing needs of expanding economies worldwide.

These issues have been extensively studied. The U.S. Energy Information Administration (EIA) projects that between now and 2040, global demand for all forms of energy will grow. It's expected to be slow growth for coal; much faster growth for renewables and natural gas. The changes should be most visible in electricity generation, while natural gas also is seen making notable gains as a transportation fuel. Still, in 2040, coal is expected to remain the world's largest energy-related source of CO<sub>2</sub> emissions.

At Devon, we support a consistent, reliable regulatory framework; society depends on measures that are both effective and economically viable. As 55 percent of the world's energy comes from oil and natural gas, curtailing these resources could hurt economic growth and diminish the quality of life for millions of people.

As demand grows for renewables in the years ahead, natural gas is expected to overtake coal, becoming the No. 2 source of energy behind oil around 2030. And by 2040, oil and natural gas together will still account for 55 percent of worldwide energy consumption, according to EIA.

Natural gas already is assuming a greater role. It burns cleaner than coal, emitting less than half the CO<sub>2</sub> and virtually none of coal's pollutants like mercury and sulfur. Natural gas is plentiful, affordable and accessible in North America and around the globe. At Devon, we are particularly well positioned to help meet growing demand for natural gas.

We expect development of new energy sources to continue. Meanwhile, it's our job to produce the energy the world needs now, and to do so thoughtfully and responsibly. We execute our plans based on rigorous analysis of the global outlook for energy, including the prospects for new regulations. We are confident that oil and natural gas will remain the world's most affordable and accessible forms of energy for many years to come.

The company adopts a similarly combative tone in its 2016 [response](#) to CDP's climate change survey, where it discusses the reputational risk associated with climate change:

There is risk from misinformation concerning [greenhouse gas (GHG)] emissions associated with natural gas and oil sands production. It is being disseminated through a range of media sources, resulting in inaccurate public perception and potential regulatory pressures. For example, misinformation from groups opposed to oil and natural gas production have prompted regulators to examine the environmental impact of hydraulic fracturing. These studies have taken years to complete and have created uncertainty surrounding future regulatory mandates. Another example involves Canada's oil sands where there is significant attention on GHG emissions. Inaccurate perceptions surrounding these issues could result in new regulations. This risk could affect Devon's ability to develop and operate new projects and export oil sands production to other jurisdictions, which could have a direct impact on profitability.

While climate change poses reputational risk, its cost poses no additional financial implications beyond what we are already pay [sic] for our overall effort to earn and maintain the public's trust. Misinformation and controversy surrounding hydraulic fracturing and the Canadian oil sands weighs on trust the public has in Devon. Our social license to operate is earned and maintained through a record of safe and environmentally responsible production operations. Devon also builds trust through communications with stakeholders. Our communications effort and the work we do to be safe and environmentally responsible are ongoing and normal functions associated with our business. No special costs are isolated. Regardless of the issue, our objective is to be compliant with regulations, to be good neighbors and to build trust on environmental issues through regulatory compliance, communications and public education.

To explain why it perceives no inherent risk to its business from climate change, Devon offers the following, in apparent repudiation of established climate science:

Without a clear understanding of specific changes the climate might experience over time, it is impossible for us to identify risks that would be unique to a changing climate scenario and exactly how those physical risks might affect our business. We are not certain what types of weather a climate change scenario might bring. Will it bring excessive heat, cold, dry periods, severe weather, all of the above? What regions will these changes occur in? There are no certain answers to these, and many more, basic questions. Consequently, we are not in a position to make long-term business plans based on wide ranging, incomplete and speculative information about future weather patterns.

Meanwhile, our facilities our [sic] engineered to adapt to changes in the environment. As with all potential concerns associated with our business, we will continue to monitor weather patterns and the science surrounding climate to determine any recognizable risks. If we do identify physical changes that could pose risks of disruption, we will consider mitigating actions.

The company does not elaborate on how its facilities are designed for adaptation.

**Greenhouse gas emissions:** Devon Energy has programs in place to reduce its greenhouse gas emissions, focusing on energy efficiency, lead detection and flaring reduction. The company reports a 9.6 percent reduction in its emissions intensity relative to production from 2013 to 2015, the most recent year for which it has published data. Its absolute emissions have increased as it ramped up production in Canada. The company reports its absolute and relative emissions annually to CDP, but beyond a single chart in its 2016 CSR report, Devon offers no year-on-year historical data to evaluate its progress over time. Devon has no emissions reduction targets, save for those required of it by Canadian law.

**Stranded asset risk:** Canadian oil sands are among the highest-cost resources the fossil fuel industry currently exploits, and are thus of particular concern in any discussion of stranded carbon assets. Nearly one-quarter of Devon's proved reserves are in Canadian oil sands. (*See Si2's 2017 Briefing Paper on Climate Change for a detailed discussion of stranded assets and their link to high-cost hydrocarbon exploration and development.*)

In its February 2017 [11<sup>th</sup> annual review](#) of oil sands supply costs, the Canadian Energy Research Institute (CERI) pegs breakeven costs at \$43.31 per barrel for steam-assisted gravity drainage (SAGD) projects and \$70.08 per barrel for a stand-alone mine. These figures exclude blending and transportation

costs but include capital expenditures. The higher mining costs stem from higher capital requirements, higher non-fuel operating costs and higher royalty payments. Factoring in blending and transportation, WTI equivalent costs increase to \$60.52 for SAGD and \$75.73 for a stand-alone mine. The big jump in SAGD breakeven costs reflects the high price of diluent required to blend the bitumen product. Devon primarily relies on SAGD, and incurs oil transportation costs, thus subjecting the company to CERI's \$60.52 per barrel break-even price. For comparison, the [WTI Crude index](#) against which CERI benchmarks its estimates plunged below \$50 in early 2015, and has since fluctuated around that price. The WTI has dropped below \$30 since 2015, and only once surpassed \$60 in May 2015. In the last year, the WTI has ranged from \$43.76 to \$57.95, well below CERI's break-even price for Devon's operations.

CERI concludes that no greenfield oil sands project is economically feasible under the current pricing environment. However, the report concedes the same could be said for any new oil development around the world, and profitability will improve considerably when (not if) oil prices eventually recover.

Devon Energy makes the following statements in its 2016 Form 10-K relative to its oil sands operations (emphasis added):

Our operations in Canada are focused on our heavy oil assets in Alberta, Canada. Our most significant Canadian operation is our Jackfish complex, an industry-leading thermal heavy oil operation in the non-conventional oil sands of east central Alberta. We employ a recovery method known as steam-assisted gravity drainage at Jackfish. The Jackfish operation consists of three facilities. In 2014, we brought the third phase of Jackfish into operation, which ramped up to facility capacity by the third quarter of 2015. At **\$55/Bbl WTI**<sup>1</sup>, direct cash margin from our Heavy Oil assets has the potential to approach \$800 million in 2017. We expect Jackfish to maintain a reasonably flat production profile for greater than 20 years requiring only approximately \$200 million of annual maintenance capital based on current economic conditions.

Our Pike oil sands acreage is situated directly to the southeast of our Jackfish acreage in east central Alberta and has similar reservoir characteristics to Jackfish. The Pike leasehold is currently undeveloped and has no proved reserves or production as of December 31, 2016. With our 50% partner, we continue to evaluate our development timeline for Pike.

In addition to Jackfish and Pike, we hold acreage and own producing assets in the Bonnyville region, located to the south and east of Jackfish in eastern Alberta. Bonnyville is a low-risk, high margin oil development play that produces heavy oil by conventional means, without the need for steam injection.

In 2017, we plan approximately \$300 million of capital investment in our Canadian Heavy Oil business...

**The royalty calculation in Canada is a significant factor in the profitability of Canadian oil and gas production.** Oil sands crown royalties are determined by government regulations and are generally calculated as a percentage of the value of the gross production, net of allowed deductions. The royalty percentage is determined on a sliding-scale based on crown posted prices. For pre-payout oil sands projects, the regulations prescribe lower royalty rates for oil sands projects until allowable capital costs have been recovered. In early 2016, the Alberta government adopted the recommendation of its Royalty Review Panel. The new royalty framework preserves the existing royalty structure and rates for oil sands. For conventional oil and gas royalty calculations for wells drilled after January 1, 2017 in the Modernized Royalty Framework, the calculation is based on a percentage of production net of allowed deductions...

**In 2015, Alberta released a new Climate Leadership Plan. This plan includes implementing an economy-wide carbon price effective in 2017. The plan also includes a legislated limit for oil sands emissions and a methane emission reduction plan which are under development. Regulations are expected to be finalized by 2018. It is expected that these initiatives will create additional costs for the Alberta oil and gas industry. Presently, it is not possible to accurately estimate the costs we could incur to comply with any law or regulations developed.**

---

<sup>1</sup> At the time of writing, the WTI was valued at \$49.52. At no point in the preceding year has the WTI reached \$55.

A 2014 study from IHS Energy, an oil and gas consulting firm, called [Deflating the “Carbon Bubble”: The reality of oil and gas company valuation](#), calls into question some of the underpinnings of stranded carbon asset scenarios. The report finds that while proved reserves on average account for only 24 percent of the resource base by volume, they account for 84 percent of the 2014 resource base that drives a company’s total valuation. Therefore, reserves that are expected to be produced beyond a 15-year time horizon have limited impact on a company’s valuation.

In January 2015, the [Carbon Tracker Initiative](#) (CTI) —an independent financial think tank that provides “in-depth analysis on the impact of climate change on capital markets and investment in fossil fuels, mapping risk, opportunity and the route to a low carbon future”—published a [response](#) to the IHS report cited above, arguing that it ignored price and reinvestment risks, overestimated the extent to which the world would continue to need fossil fuels and disproportionately blamed coal even as oil is the largest primary source of energy. The CTI offered the following key takeaways and action points:

- Carbon Tracker’s “Carbon Supply Cost Curve” analysis has focused on the break even prices of high cost capital expenditures and why these can potentially become wasted capital in a demand constrained world.
- IHS... have taken this into what we see as a narrow focus of the implications for proven reserves and short term company valuations.
- In response, we have shown that whilst the majority of a company’s [net present value] may be due to near-term (the next 10-15 years) cash flows from proven reserves, if these cash flows are recycled and invested in new future production then the value is simply rolled over with greater risk.
- Further, even using the IHS approach of no reinvestment and looking at current proven reserves only, deterioration in the oil price driven by expectations of future demand weakness could cause cash flows to weaken and valuations to fall...
- We expect the transition towards a 2°C scenario to be driven by efficiencies, falling renewable energy costs and climate regulation, with or without a “global deal”. The impacts for fossil fuel company business models should be seriously considered.
- The key point is that, rather than diluting performance by investing cash flows from historic high-return projects into newer low-return projects, companies might improve returns and lower risk for shareholders by boosting dividends and buying back shares.
- Investors must question industry assumptions and challenge capital expenditure at the wrong end of the cost curve. It is not too late for the transition to a lower-carbon economy to be an orderly one, with fossil fuel companies steadily shrinking overall but delivering the best results for their shareholders by focusing on value rather than volume.

According to a [February 2014 study](#) from Columbia University’s Center on Global Energy Policy, capital expenditures (capex) by the largest oil companies had risen five-fold since 2000, yet overall industry production was nearly flat. The study authors interpreted this trend to mean that capex productivity (in the sense of barrel of production capacity per capex dollar invested) had fallen by a factor of five since 2000. According to a December 2014 [Goldman Sachs analysis](#), in the preceding two years, no major new oil project had come on stream with production costs below \$70 per barrel, with most in the \$80 to \$100 dollar range, raising the risk of stranded assets.

An estimated \$380 billion worth of oil and gas projects have been cancelled since 2014, according to a January 2016 [estimate](#) from Wood Mackenzie. The report says that 68 major projects around the world were scrapped in 2015, which account for around 27 billion barrels of oil and natural gas. In the latter half of 2015, when oil prices fell once again following a modest rebound in the spring, the industry pushed off 22 major projects worth 7 billion barrels of oil equivalent. The cancellations are projected to lead to dramatically lower oil production in the years ahead. An estimated \$170 billion in capex spending

was slashed for the period between 2016 and 2020. All told, industry cuts will translate into at least 2.9 million barrels of oil production per day that will not come online until at least sometime next decade.

The CTI published a study in July 2016 in concert with the United Kingdom’s Local Authority Pension Fund Forum (LAPFF). In *Engaging for a Low Carbon Transition: Why a 2°C Business Model Is Less Risky than ‘Business-As-Usual’ for Oil Companies*, the CTI asserted:

Most oil companies follow an ‘invest-for-growth’ business model aiming to grow production steadily. Ironically, in many cases, this model has failed to deliver top-line growth. Even more concerning for shareholders, it has delivered deteriorating returns over the past five years. The current model has clearly not delivered. A ‘managed decline’ or ‘harvest’ business model – reducing investment to match a two-degree demand scenario – would likely lower business risks, reducing the likelihood of destroying shareholder value. It would do so because such a company would be investing in lower cost assets, reducing the volatility in earnings caused by oil price movements. Reducing capital expenditure by focusing only on lower cost assets could enable companies to return more capital to shareholders over the next five to ten years.

As described earlier in this report, Devon Energy has demonstrated the sort of decline in returns the previous paragraph describes.

**Climate change denial and political influence:** One of Devon’s lobbyists—a vociferous [climate change denier](#)—scored a victory on behalf of the company in February 2017 when the U.S. House of Representatives [voted to reverse](#) the Obama administration’s regulations on flaring methane during oil and gas drilling on Bureau of Land Management public lands. Larry Nichols, Devon co-founder and [Board of Directors Chairman Emeritus](#), served as a Trump presidential campaign [energy adviser](#) and [campaign donor](#). Former Oklahoma Attorney General and current EPA administrator Scott Pruitt submitted a letter to the EPA in 2011, which was [in fact ghostwritten by Devon](#), calling for the EPA to halt its proposed regulations on methane at U.S. hydraulic fracturing sites. Ultimately, the methane rule survived this challenge after three Senate Republicans [sided](#) with Democrats against allowing a vote on the resolution to proceed, but it may come under fresh fire in the future.

**Industry precedent:** In April 2015, 98 percent of shareholders supported a management-backed resolution at **BP** similar to the pending proposal at Devon, surpassing the 75 percent threshold for making the resolution binding. The special resolution—‘Strategic resilience for 2035 and beyond’—amplified by a supporting statement, called for routine annual reporting from 2016 onward to include further information about certain activities related to climate change, including ongoing operational emissions management, asset portfolio resilience to the IEA’s scenarios (including the 450 scenario the proponent raises, and essentially equivalent to the two-degree scenario) and public policy positions relating to climate change. While *The Financial Times* [characterized](#) this development as a “major victory” for shareholder activists, [others note](#) that BP’s board of directors supported the resolution, and question the extent to which it will make a significant difference in the company’s operations. The boards of **Shell** and **Statoil** have also supported the resolution.

In a similar vein, in 2016 Canadian oil sands company **Suncor**’s shareholders [voted](#) 98.18 percent in favor of a shareholder resolution requesting a report assessing the company’s future in a low-carbon economy and seeking emissions reduction targets, energy diversification strategies and stress-testing against low-carbon scenarios. The company’s board recommended that shareholders approve the proposal, which has never happened with a U.S.-domiciled company on this issue. Suncor has openly understood and acknowledged climate science and publicly endorsed a price on carbon emissions. “Since hydrocarbons are finite resources with an environmental impact, it will be critical to use them wisely as the world transitions to lower carbon sources of energy,” [said](#) a Suncor representative. “Suncor believes our energy system is in an era of change.”

In April 2015, a group of investors representing \$2 trillion of assets under management, [filed a letter](#) with the SEC asking it to require fossil fuel companies to provide more disclosures about climate-related risks to their businesses, including “excessive capital spending on high-cost, carbon intensive projects” and highlighting “an absence of disclosure in SEC filings.” The Bank of England addressed carbon asset risk and the potential for stranded fossil fuel assets with the publication of its [One Bank Research Agenda](#) in 2015, noting that climate change presents a category of transition risk “for central banks to consider, including the potential for carbon intensive assets becoming ‘stranded.’”

**Corporate initiatives**—In June 2014, 10 oil and gas companies formed the [Oil and Gas Climate Initiative](#) (OGCI). OGCI companies [share an ambition](#) to achieve two-degree scenario limits. Founding members BP, **CNPC**, **Eni**, **PEMEX**, **Reliance Industries**, **Repsol**, **Saudi Aramco**, Shell, Statoil and **Total** produce more than one-fifth of global oil and gas production and more than 10 percent of energy supply.

**BHP Billiton**, a global mining, metals and petroleum company, has adopted a [planning process](#) that “uses scenario analysis to encompass a wide spectrum of potential outcomes for key global uncertainties.” In a 2015 [report](#), BHP Billiton outlined four possible scenarios ranging from an orderly transition to a two-degree world to a shock event that leads to a much more rapid transition to a two-degree Celsius world by 2030.

Other oil and gas companies have begun using scenario analysis to assess the direction of their businesses and to assure investors that they are poised to take advantage of new opportunities. For example, **Total** issued a [report](#) in 2016 that discusses how a two-degree scenario affects the company’s decision-making process, discusses its targets for reducing the carbon intensity of its operations over time and includes the endorsement of its board of directors for this approach. Other companies beginning to use a two-degree scenario analysis in their business planning include **ConocoPhillips**, **Statoil** and **Shell**. ConocoPhillips’ action prompted the withdrawal of a shareholder resolution on the subject last year. ConocoPhillips has also adopted the shrink-to-grow strategy CTI espouses, as described earlier in this report.

### ***Shareholder Support for This Proposal***

On May 8, 2017, the California Public Employees’ Retirement System (CalPERS) announced that it would vote in favor of this proposal and encouraged other shareholders to follow suit. CalPERS is the largest state public pension fund in the United States with \$311 billion in total assets under management, and owns approximately 1,469,000 shares in Devon Energy. CalPERS explained its reasoning in an [SEC filing](#):

Consistent with the CalPERS Investment Beliefs, we believe effective management of environmental factors, including those related to climate change risk increase the likelihood that companies will perform well over the long-term. We support the request of proposal #8 asking Devon Energy Corporation to publish an annual assessment of the long-term portfolio impacts of global climate change policies, at reasonable cost and omitting proprietary information. The report should analyze the impacts on Devon’s portfolio of oil and gas reserves and resources in a scenario in which reduction in demand results from technological innovation, carbon restrictions and related rules or commitments adopted by governments consistent with the globally agreed upon 2 degree target. The report should assess the resilience of the company’s full portfolio of reserves and resources through 2040 and beyond and address the range of financial risks associated with such a scenario.

CalPERS extended the same support to a similar resolution at **Occidental Petroleum**, which received a majority of votes in favor this year in an industry first. Asset manager BlackRock also [supported](#) that proposal and urged other investors to do the same. BlackRock also owns shares in Devon Energy, but the mutual fund has not disclosed its voting stance on this shareholder resolution at Devon. BlackRock’s proxy voting guidelines, which it issued in March 2017, say the following:

The [BlackRock Investment Institute](#) has published two papers – “[The Price of Climate Change – Global Warming’s Impact on Portfolios](#)” and “[Adapting Portfolios to Climate Change](#)”– on climate change as an investment consideration, to which the Investment Stewardship team contributed. That work enhanced our understanding of the complexity companies and investors face in relation to climate change and has informed [our engagement with companies on the anticipated impact of climate change on their business models and operations over time](#). We believe that enhanced, meaningful disclosures are an important step towards building understanding of the impact on individual companies, sectors and investment strategies. Given climate risk is a universal issue, we believe disclosure standards should be developed that are applicable to listed companies across each market and, ideally, that are globally consistent.

To that end, BlackRock was represented on the 32 member, industry-led Financial Stability Board Task Force on Climate-related Financial Disclosures (“TCFD”). The TCFD has released preliminary [recommendations](#) around four thematic areas that represent core elements of how organizations operate – governance, strategy, risk management, and metrics and targets. This framework offers companies and investors a starting point to assess, report, and price climate-related risks and opportunities. In our view, the TCFD recommendations, which include sector-specific supplemental guidance, provide a relevant roadmap for companies. Over the course of the coming year, we will engage companies most exposed to climate risk to understand their views on the TCFD recommendations and to encourage them to consider using this reporting framework as it is finalized and subsequently evolves over time.

## II. Proponent Position

The proponent notes that governments are realizing that to minimize global temperature rise to two degrees Celsius and to avoid the most severe of negative ramifications for the planet, deep cuts in greenhouse gas emissions are needed. It quotes the International Energy Agency (IEA) and other sources that predict transport electrification presents a substantial threat to the oil and gas industry, as described earlier in this report.

Given the Paris Agreement, the proponent believes it would be wise for Devon to conduct scenario analyses and stress testing aligned with the 2-degree limit on average global temperature increase set in the treaty. The proponent points to Devon’s high-cost Canadian oil sands operations and Canada’s moves to cap greenhouse gas emissions, which it believes enhances the need for stranded asset analysis. The proponent notes that a growing number of Devon’s peers are conducting and reporting on such analyses, and points to the growing number of asset managers and credit rating agencies that have called for improved climate risk disclosure and begun to analyze low-demand scenarios, as described earlier in this report.

The proponent asserts that Devon “has almost no disclosure on this critical issue,” saying its proposal “aims to ensure that Devon fully evaluates and mitigates risk to the viability of its assets under a 2 degree scenario.”

## III. Management Position

Management opposes the resolution in a statement that is nearly unchanged from last year. The board asserts that climate change risk-related information is already available and that the requested report would be “costly, duplicative and likely to include proprietary data and plans.”

Management says that, as a “highly regulated business subject to extensive disclosure requirements,” Devon already provides information requested by the proposal through its SEC filings, including as one of the “risk factors” outlined in its Form 10-K. Its 10-K discusses the “potential effects of climate change on our operations as a result of taxation, regulation and decreased demand for carbon-based fuels,” management notes, as well as noting that it has been able to “comply with environmental ... initiatives without materially altering [its] operating strategy or incurring significant unreimbursed expenditures.”

In addition, Devon has specific disclosure requirements for its reserves, management notes, and “any third party” who audits its reserves is required to report on the “possible effects of regulation on [its] ability to recover the estimated reserves.” Management says that its Form 10-K will continue to discuss climate change-related risk factors, including compliance with environmental laws and regulations, volatility of oil and gas prices, the potential impact of public policy and the potential costs of pollution clean-up and related projects.

Management also notes that it discloses climate change related information in its corporate social responsibility report, which is available on its website and “sets forth several of the Company’s initiatives aimed at producing energy in environmentally responsible ways.” The company has invested in technologies to reduce emissions in its operations, management says, listing a few examples of such projects. Management also notes that Devon has voluntarily responded to CDP’s climate change and water surveys, which include disclosure of “identified risk, ... estimated financial implications, methods for management of the risk and costs of management.”

In addition to the already existing information, management says that the requested report “would require ... pure speculation on matters outside of its control far into the future.” While SEC regulations “require that *undeveloped proved* reserves must have a plan to be developed within the next five years,” management asserts, the proposal would have the company “consider risks and opportunities related not only to undeveloped proved reserves, but unproved reserves and theoretical future reserves decades into the future.” It asserts that “there is no ‘reasonable cost’ for conducting such an assessment,” noting that some of the requested information “could be valuable to [its] competitors.” Management asserts that it would not be in shareholders’ best interests “to expend corporate funds and employee time” to engage in “unmitigated speculation,” and recommends a vote against the proposal.

## IV. Analysis

### *Key Points at Issue*

- How does Devon Energy stack up to its competitors on climate change risk management?
- Do Devon’s present disclosures address the information requested by the proponent?

*Si2’s 2017 Briefing Paper on Climate Change contains a detailed analysis of climate change issues, including stranded assets, that investors may want to consider. The following discussion is specific to Devon Energy.*

Devon is a major oil and gas company with nearly a quarter of its proved reserves in Canadian oil sands. Like so many of its peers, the company has seen falling revenues in recent years as a result of dramatically declining oil prices. In response, the company is tightening up its operations, with substantial cuts in capital expenditures. Devon reports modestly declining relative greenhouse gas emissions over the most recent three-year reporting period, with an increase in absolute emissions that it chalks up to a ramp-up in Canadian operations. The company has no emissions reduction targets beyond those legally mandated by Canada.

Multiple studies show that climate change poses risks to fossil fuel companies, possibly existential risks, among which is asset stranding. Until now, scientists and governments have generally understood that keeping average atmospheric temperature to no more than two degrees Celsius of warming was the mechanism by which the worst negative impacts from climate change could be averted. In fact, the latest research suggests that even two degrees could be too much, and that 1.5 degrees Celsius may actually be the maximum threshold. This assessment supersedes whatever regulatory bodies choose to do. The science does not trouble itself with political stagnation.

The Paris climate treaty reached in December 2015 initially prompted optimism from many about new prospects for a real shift in global government action to address climate change. The outcome of the 2016 presidential election and the new Trump administration's stated intention to abandon many of the existing U.S. climate initiatives may delay some movement at the federal level. Many analysts do not believe that a temporary shift in U.S. policy will derail decarbonization efforts, however. They believe that regulation is inevitable, given the scope and impact of the problem, and that if such regulation is delayed, it will constitute a greater shock when it is ultimately passed. They argue that companies would create a strategic advantage by adjusting their business models now. Meanwhile, Canada—where Devon has significant operations—is a staunch supporter of the Paris Agreement, and is poised to implement an economy-wide carbon price, impose a legal limit on oil sands emissions and institute a methane emissions reduction plan. Devon acknowledges that this would add costs to an expensive area of operations that is already threatened in the current oil price environment.

Meanwhile, many leading global asset managers are now advocating for greater climate change risk management and disclosure, and many large institutional investors are convinced that companies and governments must take urgent action to address climate risks; they are paying ever closer attention to how their portfolio companies are strategically situated to handle climate-related risks and opportunities. The support of large asset managers led to a majority vote in favor of this proposal at **Occidental Petroleum** this year, an industry first. Also this year, some oil and gas companies have come out in support of the Paris Agreement, raising the prospect that President Trump may be under pressure to rethink his position.

Some of Devon Energy's peers are moving ahead on the two-degree scenario now. A number of energy companies including **Shell, BP, Statoil, BHP Billiton** and **Total**, have endorsed requests for stress-testing portfolios for resilience to a two-degree scenario. In addition, ten oil and gas companies support achieving the two-degree target as part of the Oil and Gas Climate Initiative. **ConocoPhillips, Statoil, Total, Shell** and **BHP Billiton** have conducted two-degree scenario analysis, with Conoco's action prompting the withdrawal of a shareholder resolution on the subject last year. The more companies take up this approach, the less credible becomes Devon's claim that the requested report would disadvantage the company by revealing proprietary information.

Devon Energy's limited climate change reporting contends that the company is at no substantial risk, and does not offer the detailed risk reporting the proponent seeks. The proponent is looking for a full accounting of potential downside risks in a carbon-constrained world that tries to achieve no more than two degrees of global warming, potentially jeopardizing nearly a third of the proved reserves of the oil and gas industry.

While generally acknowledging regulatory risk, Devon Energy pushes back at the proponent's asset stranding assertions. It includes a detailed explanation about why it believes its assets will not be stranded in its CSR report and proxy statement. In essence, it says that policy makers will not act promptly to curtail demand for oil and gas to the extent foreseen by the proponent, and even if governments act, they will first focus on coal. It believes energy demand, much of it from oil and gas, will persist well into the future.

Devon Energy says the report requested by the proponent would be costly. Indeed, it would take considerable staff resources to complete an analysis of the scale requested by the proponent and to publish a report. The question for shareholders is whether it would be useful. The scenarios cited by the proponent come from reputable organizations. U.S. regulation has lagged behind these recommendations, but Canada appears to be moving ahead briskly. Devon seems to be hedging its bets, waiting for additional guidance from regulators before calculating potential impacts and planning—while pushing back about the reasons for doing the requested scenario analysis.

Ultimately, Devon Energy finds itself in a conundrum as a growing number of its peers acknowledge the exigencies associated with climate change, and in some cases conduct the sort of assessment requested by the proponent. It must either try to obscure the fact that the success of its current portfolio depends on a global failure to act on climate change, or accept that it needs to become something more than an oil and gas company. Shareholders may wish to contemplate whether Devon Energy is best managed as a fossil fuel company, or as an energy company with a broader, more nimble purview than that which its management currently envisions.

### ***Voting Considerations***

**Votes in favor:** Investors who share the proponent’s view that the company is not fully reporting on the financial and operational risks associated with climate change will vote in favor of the resolution. They are likely to believe the company’s oil and gas reserves could see a significant drop in value under certain low carbon scenarios and that management’s related analyses and action plans are key to assessing their investment in the company. Investors who are concerned that Devon Energy is falling behind its peers in this regard may also want to vote for the resolution.

**Votes against:** Investors who are satisfied with the company’s existing reporting on climate change and related risks will vote against the resolution. Investors who agree that Devon Energy is not in a position to assess the global risks of climate change also will agree that the company should not spend resources on speculative analyses. Investors who agree with the company that the requested analysis would force the company to reveal proprietary information will also vote against the resolution.

### **Resources**

- Devon Energy’s 2016 Form 10-K  
[https://www.sec.gov/Archives/edgar/data/1090012/000156459017001607/dvn-10k\\_20161231.htm](https://www.sec.gov/Archives/edgar/data/1090012/000156459017001607/dvn-10k_20161231.htm)
- Devon Energy’s 2017 Proxy Statement  
<https://www.sec.gov/Archives/edgar/data/1090012/000119312517137053/d335277ddef14a.htm>
- Devon Energy’s 2016 Corporate Social Responsibility Report  
[http://www.devonenergy.com/documents/Social-Responsibility/2016-CSR-Report/DVN-2016-CSR\\_FINAL\\_Updated.3.7.17.pdf](http://www.devonenergy.com/documents/Social-Responsibility/2016-CSR-Report/DVN-2016-CSR_FINAL_Updated.3.7.17.pdf)
- Devon Energy’s 2016 response to CDP’s climate change survey (registration required)  
<https://www.cdp.net/en/>