

# Confronting Inconvenient Truths in the Alberta Oil Patch

BY ROB ABBOTT, DELOITTE

A “tipping point”, as Malcolm Gladwell pointed out in his enormously popular book of the same name, is the moment in an epidemic when a virus reaches critical mass. It is also the moment in business, or any aspect of life, when something – a book, a movie, or an idea – suddenly explodes and becomes an accepted part of the cultural firmament. Al Gore’s recent acceptance of an Academy Award for ***An Inconvenient Truth*** was just that. Make no mistake, climate change has officially “tipped”.

Despite at least a decade’s worth of hard physical evidence, and several recent global surveys demonstrating increased awareness of climate change among business leaders<sup>1</sup>, it took Mr. Gore’s film to move climate change out of the academic and policy backwaters and firmly into the mainstream. Perhaps there is truth in the adage that there is nothing so powerful as an idea whose time has come. Everyone – businesses, individuals, and governments – is now talking about climate change. And it’s not just about talk; several important actions are now being taken to address climate change, especially within financial and investment institutions:

- In 2004, RBC modeled the impact of the monetization of carbon on selected corporations in a number of different sectors using publicly available information.
- In 2003, the Carbon Disclosure Project (CDP), a coalition of institutional investors, issued GHG emissions disclosure requests to the FT500 largest companies to begin assessing carbon risk as part of the investment analysis. The fifth CDP request, on behalf of 280 institutional investors, was sent to 2400 global companies in February 2007.
- JPMorgan Chase added carbon disclosure and mitigation measures to their client review process in 2005.
- Goldman Sachs has established a climate change policy for their foundation
- Morgan Stanley is spending \$3 billion on emission reduction projects
- On March 27, 2007 the Canada Pension Plan Investment Board signaled its intent to demand more transparency from the companies it invests in when it comes to environmental, social and governance factors. In particular, the CPP noted that it wants companies to reveal how they intend to deal with their carbon impact and their plans for mitigating it.

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<sup>1</sup> For example, on March 20, 2007, the *Globe and Mail* reported that Canadian executives believe climate change to be the 2<sup>nd</sup> most important issue facing Canada.

## TIPPING POINT FOR CLIMATE CHANGE IN ALBERTA

In many respects, the above developments created the system conditions for the single action that has immediate operational and strategic implications for Alberta oil companies – on March 8, 2007 Alberta became the first province in Canada to introduce legislation to reduce greenhouse gas emissions from industry. With this announcement came immediate and strategic implications for Alberta oil companies and other large emitters of greenhouse gases. Alberta Bill 3, which amends the ***Climate Change and Emissions Management Act***, and the supporting ***Specified Gas Emitters Regulation***, directs industrial facilities producing 100,000 tonnes of greenhouse gas (GHG) emissions annually to reduce the intensity of those emissions by 12% starting July 1, 2007 or pay a \$15/tonne penalty. Roughly 100 facilities in the province are affected. Premier Stelmach and Prime Minister Harper have also recently announced creation of a federal-provincial task force to recommend financing options for a carbon capture and sequestration system. Collectively, these actions accelerate the strategic importance of climate change in Alberta<sup>2</sup>.

While economists may debate the price point, and environmentalists may argue that a focus on intensity of emissions misses the larger point of reducing our overall CO2 footprint, the recent actions in Alberta set an initial benchmark for Canada. The question now is how should industry respond?

### A STRATEGIC RESPONSE TO BILL 3

On the one hand, responding to Bill 3 is straightforward. Compliance with the emissions intensity targets can be achieved in three ways:

- Operational changes which lower emissions
- Paying \$15/tonne for emissions in excess of the 12% target, with money paid into a greenhouse gas emissions reduction technology fund
- Purchasing an offset<sup>3</sup>, which must be Alberta-based and third-party verified.

Before companies rush out and make one or more of these investments, however, it is important to recognize that reducing GHG emissions (or emissions intensity) is but one aspect of a broader climate

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<sup>2</sup> The recent federal budget further heightened the importance of thinking strategically about climate change with that pledges to “rebalance” the tax system to encourage investment in renewable energy, allocate \$1.5 billion to boost ethanol and biodiesel production, and phase out the accelerated capital cost allowance for oilsands development.

<sup>3</sup> An offset is an action or project which has reduced greenhouse gas emissions since 2002 when the ***Climate Change and Emissions Management Act*** was first introduced; and has been undertaken where not required by law.

change strategy. And that means that a conversation that has thus far been the domain of environmental or sustainable development departments needs to be broadened. Specifically, it is time to engage the CFO and the CEO and elevate this issue through to the Board of Directors. Climate change is rapidly becoming a strategic issue for business with potential material risks to the long-term financial health of a company. Without a broader perspective on this issue, many companies will fail to consider all of the risks associated with climate change.

Last year, Deloitte assessed the state of readiness of Canadian industry for the coming carbon-constrained environment. The report that emerged from that assessment, ***Forward Thinking: The Importance of Managing Greenhouse Gas Emissions***, highlighted good progress among respondents in raising awareness of GHG emissions, and the establishment of emission baselines. However, in a majority of companies emission abatement targets and schedules had not been set; no clear budgets for executing carbon reductions had been established; and little thought had been given to how disclosure should (or could) be handled. Further, in many cases, GHG/climate change plans had not gained visibility beyond the plan's initiators, nor had they resulted in coordinated actions and policies. Perhaps most important, although 80% of respondents to our 2006 survey ranked GHG emissions management as an issue of moderate to critical importance, 50% did not include GHG emission management in their overall risk management policy or strategy.

Climate change creates highly interdependent risks in the business environment (regulatory, technological, price/market, strategic, physical operations, volume, modeling/valuation, and so on) that have implications across a business' global operations. Companies should therefore frame their thinking about climate change in an enterprise risk management context to ensure that an accurate and complete enterprise risk profile is created. As shown in figure 1, there are both internal and external actions that should be taken to create the risk profile, and manage key risks strategically.

Internally, it is critical to reframe what might otherwise be a greenhouse gas emissions discussion as a climate change discussion and articulate a vision of the future in which your company is resilient under several different carbon scenarios. This means a tight coupling between climate change and organizational strategy, something that is still quite new in environmental or sustainability management. Equally important, baselines of current carbon exposure (not only emissions) at every link in a company's supply and value chains should be established. This will highlight risks and opportunities and facilitate an enterprise-wide discussion of where and how to act – both to meet compliance obligations, but also to gain maximum leverage in creating business value by reducing the carbon footprint.

Externally, it is important to actively engage in shaping your company's own future by taking part in regulatory discussions over and

above what your industry association may already be doing, by participating in emerging markets for carbon trading, and by ensuring that carbon is considered in every business decision and transaction.

**Figure 1 – Responding to Alberta Bill 3 Strategically**

### Proactive actions to prepare and influence

#### Internal focus

- Reframe the GHG discussion as a climate change discussion and elevate it to the senior management and Board - what is your company's vision of the future? Identify a leader.
- Accurately measure and forecast GHG emissions / emissions intensity (establish baseline from which the future will be measured). Assess emissions data management systems.
- Conduct scenario analysis - develop and model alternative emissions scenarios and evaluate the environmental, social and financial consequences.
- Develop climate change risk management framework (or integrate into your enterprise risk management - identify risk factors, build consequence/likelihood scales, risk treatment options
- Assess climate change risks and opportunities
- Accurately disclose the impact that climate change may have on your company's financial position in the market.

#### External focus

- Get involved - participate in working groups
- Learn through voluntary markets – e.g. participate in emissions trading markets and build capacity to manage transactions.
- Benchmark and report
- Consider carbon in mergers and acquisitions

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Collectively, these actions go a long way toward clarifying what a climate change strategy looks like. They should help companies frame a strategic response to the new Alberta legislation, *and* position themselves for the additional regulatory and public opinion changes that are sure to follow. Alberta can remain a global energy superpower, but to ease the transition to a future of less CO2 intensive energy, broadly-based strategic shifts in thinking about climate change need to start happening now.

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