

Divest-Invest: Emissions Impossible Stranded Assets Note

This note was developed to provide further insight into 'stranded assets theory'. It was written to increase campaigners' confidence in articulating arguments for fossil fuel divestment to senior managers.

What are stranded assets?

Fossil fuel companies' shares are valued based on the amount of coal, oil and gas they have discovered and how much it will cost to extract these reserves.

However, it is a widely accepted belief - from [the Bank of England](#) to the [International Energy Agency](#) - that some of these potential 'assets' will become 'stranded' when they are unable to be extracted due to alternative technologies and the increasing cost of carbon. Mercer's (an investment consultancy) large-scale research into climate risk management has corroborated this, making clear the necessity of having climate change included in investment decisions (Investing in a Time of Climate Change, 2015).

Carbon Tracker forecast that 33% of the business-as-usual expenditure on finding new oil and gas reserves is inconsistent with the 2-degree scenario the international community have agreed upon as the limit for global warming (2-degrees of separation, 2017).

Carbon Tracker's research allocates excess capital expenditure - based on what oil companies can reasonably expect to exploit as based on the 2-degree global carbon budget as committed to in the Paris Agreement 2015 - at the individual company level. They place oil companies into bands, forecasting the extent of their

investment into projects that are unlikely to progress towards the upstream (extraction and production) stage if they are to remain with the global carbon budget. In these projections it is evident that some oil companies are risking a significant proportion of their investments.

Three of the top oil companies risking their future spending include:

- ExxonMobil, risking 40-50%;
- Royal Dutch Shell, risking 30-40%;
- BP, risking 20-30%.

This indicates a high likelihood of stranded assets given that these companies are putting money into projects that are inconsistent with a 2-degree scenario and therefore are never likely to be used. Each time it becomes clear an oil or gas field is worthless, it will have a significant detrimental impact on the share price of that company.

But don't the markets factor asset stranding into company share valuations?

No. There are countless times in the past when investors have massively mispriced companies, sectors and even the whole market. It is why share prices move all the time - new information and new interpretations of information change investor perceptions of company value. Examples of previous failings of the market include the financial crisis that started in 2007/8 - when US mortgage debt was mispriced by some of the biggest and, supposedly, most sophisticated investors in the world - and the Dot Com Boom in the early '00s where people were paying a fortune for companies with no earnings.

What are experts doing to tackle this?

Mark Carney (Governor of the Bank of England), Michael Bloomberg (former



Mayor of New York and entrepreneur) and many institutional investors are asking for better data disclosure to mitigate this problem - if the information was already included in the valuation, this extra data wouldn't need to be requested. There is a task force specifically focused on this. Their final recommendations can be found [here](#). Particularly pertinent from the report is:

“Compounding the effect on longer-term returns is the risk that present valuations do not adequately factor in climate-related risks because of insufficient information. As such, long-term investors need adequate information on how organizations are preparing for a lower-carbon economy.”

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