

A Vision for the Lower Athabasca Region: an ESG Investing Perspective (October 2010)

Introduction

With \$4.7 billion in assets under management, Northwest & Ethical Investments L.P. (NEI)'s approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will provide higher risk-adjusted returns over the long term.

Within its funds, NEI has holdings in companies operating in the Lower Athabasca region - the focus of Alberta's oil sands industry. Awareness has been increasing among investment institutions that environmental and social impacts of oil sands development could pose risks to long-term company value. Risk is heightened in a context of major projects with significant development costs and long investment horizons. We have well-established ongoing ESG dialogues with a number of public companies operating in the oil sands, but some risks can be most effectively mitigated by public policy initiatives. In particular, policy action is needed to manage the cumulative impacts of development - which can wipe out the effect of performance improvements by individual companies, and increase risk for all.

The Alberta Government is undertaking a strategic land use planning exercise, which has potential to address various aspects of oil sands ESG policy risk. In August 2010, the Lower Athabasca Regional Advisory Council published its *Advice to the Government of Alberta Regarding a Vision for the Lower Athabasca Region*¹, which will inform the development of the Lower Athabasca Regional Plan (LARP). The Advice touches on many issues of importance from an ESG risk mitigation perspective, including the need to manage cumulative impacts, and to set impact thresholds and limits. The following pages outline NEI's comments on the Advice.

Optimizing the economic potential of the oil sands

Objective 1.1 within the Advice envisions that *"the economic potential of the oil sands is optimized"*. Economic optimization does not necessarily equate to maximizing the scale or encouraging the fastest possible expansion of the oil sands industry. The period of rapid growth that preceded the global economic crisis fuelled cost increases that created significant challenges for project economics, as well as outpacing the capacity of companies to develop and apply mitigation measures for environmental and social impacts.

Although we acknowledge that corporate financial reporting may not reveal the full extent of a company's research effort, apparently low levels of disclosed R&D spending by oil and gas companies in general, and oil sands operators in particular, create cause for concern². Stimulating the development of new technologies to reduce impacts is therefore an important objective, as the Advice suggests. But it is equally important to encourage more rapid commercialization and dissemination of new technologies – innovations only contribute to risk mitigation if they are deployed in the field.

¹ <http://www.landuse.alberta.ca/RegionalPlans/LowerAthabasca/documents/LARP-VisionForLowerAthabascaRegion-Aug2010.pdf>

² <https://www.ethicalfunds.com/en/Investor/ChangingTheWorld/HowWeWork/ResearchAndLobbying/Pages/LinesInTheSands.aspx>

Establishing a world-class protected area network

Establishing a world-class regional protected area and conservation lands network could enhance Alberta's reputation, increase certainty that company leases will not come into conflict with conservation obligations, and reduce indirect litigation risk relating to possible infringements of protected species legislation or Aboriginal treaty rights. ESG risk mitigation effectiveness will depend on the extent, permanence and quality of the conservation commitment, and how the conservation management regime integrates Aboriginal rights.

The Vision identifies recommended conservation areas that would raise the area of the region under protection to 20-32%. We note that 20% would represent the lowest end of the recommendation of the Cumulative Environmental Management Association (CEMA) Terrestrial Ecosystem Management Framework for conservation areas within the Regional Municipality of Wood Buffalo³. As a member of the Boreal Leadership Council (BLC), we support the Boreal Forest Conservation Framework (BFCF)⁴, which calls for protection of at least 50% of Canada's Boreal region, sustainable development best practices for the rest of the land base, and respect for Aboriginal rights across the whole. The LARP represents an opportunity for Alberta to make a Boreal protection commitment that would contribute to the achievement of the BFCF, as other provinces have done. To this end, we support the recommendation of Alberta-based members of the BLC to extend protection in the Lower Athabasca Region to an area in the range of 40% of the total. Priority should be given to habitat protection for recovery of sensitive species such as Woodland Caribou, and to finalizing an effective wetland policy and conservation offset regime.

Threshold for total disturbance

The total area that could be disturbed by oil sands development has attracted international comment. Setting a threshold for disturbance at any given time at a fraction of the total area of oil sands deposits could reduce reputational risk for the industry as a whole. A challenging threshold could stimulate companies to efficiency improvements and timely reclamation, reducing environmental liabilities and reputational risk. However, the degree of positive impact depends on the choice of threshold and the detail of how it will be applied at the local level and for different types of development. For example, it is our understanding that, given the same total area of disturbance, dispersed disturbance created by in situ projects may have greater impact on wildlife than more concentrated disturbance created by oil sands mining. The Advice proposes a 15% threshold for disturbance at any given time in the "mixed-use" area, but does not provide detail on how this threshold will be applied. In this context, we note that the CEMA Terrestrial Ecosystem Management Framework contained a more precisely-articulated proposal for a disturbance threshold within the Regional Municipality of Wood Buffalo.

Progressive reclamation regime

A further topic of international comment is the small area of land disturbed by oil sands that has been certified as reclaimed. Companies tell us that reclamation is progressing faster than reclamation certification data would suggest, and that in some cases they are hesitant to apply for final certification of reclaimed lands because of continuing access requirements. It would be desirable to establish a progressive reclamation

³ <http://cemaonline.ca/cema-recommendations/terrestrial-ecosystem.html>

⁴ <http://www.borealcanada.ca/framework-e.php>

reporting regime that makes transparent how much disturbed land has been brought to what stage of reclamation, and allows investors to compare the performance of different companies. This data would give investors greater insight into company liabilities and outstanding obligations, and could stimulate increased reclamation effort as well as reducing reputational risk. Proposals for “repurposing” disturbed land, so that it need not be reclaimed to the standard of equivalent capability before redevelopment, may be appropriate and practical in some cases. But local expectations should be considered: for example, reclamation strategy should support Aboriginal traditional uses to avoid litigation risk from possible treaty rights infringements.

Environmental management frameworks

Demonstrating that oil sands development is taking place within a context of credible environmental management frameworks could reduce reputational risk across the industry. For example, it is our understanding that groundwater availability and access could present risk for some in situ oil sands producers. To increase investment certainty for new projects, establishing resource baselines and a management framework for groundwater is desirable.

We note that the carbon dioxide management framework reference in the Advice specifies alignment with provincial regulations. The present Alberta greenhouse gas emissions reduction strategy allows for emissions growth up to 2020, and relies heavily on the rapid introduction of carbon capture and storage⁵. To take into consideration only Alberta regulations may be a risk, given that future federal, United States and international carbon regulatory frameworks would have significant implications for an export-oriented oil sands industry.

Although references are made to protecting human health, specific recommendations on strategies to address directly possible impacts of pollution on oil sands downstream and downwind communities do not appear in the Advice. Current lack of consensus about human health impacts and about the sources of air and water pollution is attracting international investor concern, and poses a significant reputational, social license and litigation risk to companies.

Regional monitoring and reporting

Strong environmental monitoring and reporting structures are vital to set baselines and reduce uncertainty about impacts. Some existing monitoring entities (such as the Alberta Biodiversity Monitoring Institute) appear to have gained wide acceptance among stakeholders, while others (such as the Regional Aquatics Monitoring Program) have suffered credibility problems. Efforts should be made to establish factors that positively or negatively impact the credibility of monitoring structures, including governance, independence, participation, transparency, disclosure and resourcing. To avoid free-rider situations, funding constructions should ensure that all companies that impact significantly on environmental resources contribute appropriately to the maintenance of independent regional monitoring and reporting structures.

Aboriginal rights

Aboriginal litigation claiming possible infringements of consultation requirements and treaty rights poses indirect risk to companies and their project investments. Land use policy that encourages improved corporate performance in Aboriginal consultation and supports traditional uses could increase certainty and reduce risk.

⁵ <http://environment.alberta.ca/01757.html>

A further step would be to consider application within the industrial leasing and approval processes of the principle of Free, Prior and Informed Consent – an emerging best practice to win and maintain Aboriginal license to operate.

Emergency preparedness

The Advice does not appear to address potential industrial emergencies, such as tailings containment failure or plant explosions, in the emergency preparedness context. The impact of such events for both communities and companies can be mitigated if emergency scenarios have been taken into account in decision-making on sites for both industrial and community development projects. Other relevant strategies could include improving community access to information on emergency planning and procedures, and promoting emergency preparedness activities in communities.

Conclusion

We commend Alberta for undertaking its land use planning initiative, and for seeking public input. In a context of global debate on oil sands development, a leading-edge and binding land-use plan for the Lower Athabasca Region could create clarity and certainty, and enhance the reputation of the province.

We believe the land use plan should be completed and implemented as quickly as possible, while taking into account the need for wide-ranging consultation. Given delays and disagreements over earlier planning exercises, a prompt conclusion is important for the credibility of the policy environment. Continuing to grant leases and approve major new developments before the plan is completed seems likely to create further scope for disagreement, and to increase investor uncertainty.