Flagging memo

Equinor ASA

Annual general meeting: 10 May 2023

Proposals are flagged by Climate Action 100+ initiative for signatories to take into consideration during proxy season. Please note that the below information is provided by and accredited to the investor who is publicly predeclaring their voting intention and rationale to other Climate Action 100+ signatories, for routine votes as well as management or shareholder resolutions.

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Organisation requesting a 'flag' on a vote

- As lead investors of the Equinor Climate Action 100+ engagement, Sarasin & Partners LLP supports the flagging of the following routine vote:
  - https://sarasinandpartners.com/stewardship-post/equinors-2023-agm-how-we-are-voting-for-net-zero/
  - https://cdn.equinor.com/files/h61q9gi9/global/a2ece0ec0261733a665fbf779ff589e9fc85afb1.pdf?notice-of-annual-general-meeting-in-equinor-asa-10-may-2023-equinor.pdf

Vote text

Sarasin & Partners is flagging one routine vote and stating their intention to vote AGAINST:

- (6) Approval of the annual report and accounts for Equinor ASA and the Equinor group for 2022, including the board of directors' proposal for distribution of fourth quarter 2022 dividend

Summary of why vote is being flagged

- The vote is being flagged as part of a long-standing engagement with Equinor, now being held under the CA100+ initiative, to press for better accounting disclosures that properly reflect climate risks and include a reliable 1.5°C sensitivity analysis. This is critical to supporting a faster and stronger shift of capital away from further fossil fuel development.
- It follows the key asks set out by investors in the Investor Expectations for Paris-aligned Accounting, published by IIGCC in November 2020, and more recent work spearheaded through the Accounting & Audit working group operating out of IIGCC, helping to coordinate engagements with European energy, materials, transport and utility companies.

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- CA100+ flagged Sarasin's pre-declared vote at Equinor on the same topic last year: https://sarasinandpartners.com/row/stewardship-post/equinor-2022-agm-voting-for-net-zero-accounting/

Questionable assumptions in Equinor's accounts

- While we welcome improved disclosures describing how decarbonisation and Equinor's own climate commitments are accounted for in its 2022 financial statements, like last year, management and the auditor have concluded that there is no reason to change any forward-looking assumptions; there are consequently no write-downs linked to climate change. But this conclusion appears to rest on questionable assumptions, most notably:
  - decarbonisation will be gradual and consistent with warming likely well above 1.5°C;
  - the use of carbon capture and storage (CCS) will enable existing and new fossil fuel assets to continue in use;
  - CCS costs associated with the Transition Plan do not need to be accounted for (as these seem to have been left out of asset impairment testing);
  - asset retirement obligations (i.e. clean-up costs that are borne when assets are closed down) remain a distant concern since asset lives remain unchanged; and
  - the cost of capital for carbon-intensive activities will not rise.
- Each of these assumptions can be challenged. What if the use of renewables and other zero carbon technology continues to accelerate, undermining demand for fossil fuels more quickly than anticipated? What if governments decide that CCS is not as effective as renewables and other clean technology, and introduce fossil fuel production limits instead? What if banks and capital markets start pricing in a premium to cover rising risks of financing carbon-intensive activities given the technological and policy disruption, pushing up

all oil and gas companies' costs of capital? These are not far-fetched ideas. In fact, many are already playing out.

Equinor's 1.5°C sensitivity seems overly optimistic

- Even in Equinor's 1.5°C sensitivity analysis, which helpfully explores the exposure of upstream assets to lower oil and gas prices and rising carbon prices, management concludes that they face a relatively low $4bn impairment risk, just 7% reported equity (31 December 2022). However, this assessment does not consider potential limits to production, or increased costs of capital. It also leaves out potential impacts for their largest business segment by sales, Marketing Midstream & Processing.
- This seems optimistic. Especially when, in a separate discussion of portfolio resilience to the IEA's 1.5°C pathway in the Annual Report, Equinor calculates that its existing portfolio could see 22% of its Net Present Value written down[2]. It also states in the Notes to its accounts that an immediate 30% reduction in commodity prices would see impairments of $14bn, around a quarter of reported equity.
- While the recent surge in oil and gas prices linked to Russia's invasion of Ukraine have provided temporary cover for all oil and gas companies, the long-term structural headwinds remain unchanged. If anything, the IEA has underlined that higher energy prices are driving faster decarbonisation, not slower[1]. Those oil and gas companies that double down on fossil fuels today will be more exposed tomorrow.

Auditor increases focus on climate in new Key Audit Matter

- We are pleased to see EY add a new Key Audit Matter (KAM) on climate change in its latest audit, reflecting its heightened scrutiny of this matter. They also have increased their commentary on how climate factors have been considered in its other KAMs, including on asset retirement obligations.
- Notwithstanding these advances, EY provides no commentary on the gaps we identify above. Specifically, EY appears to approve of Equinor's assumption

[1] https://www.iea.org/topics/russias-war-on-ukraine

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that production will be unaffected by accelerating decarbonisation and the cost of capital will remain unchanged. There is also no comment on how other business segments beyond the upstream assets might be exposed to climate risks.

Vote

- **Annual Report & Accounts (Resolution 6) – AGAINST**. While we welcome increased disclosures in the financial statements, key assumptions remain optimistic, including unchanged asset lives, production forecasts and cost of capital. Planned carbon capture and storage seems to be unaccounted for, and asset retirement obligations presumed to be a distant concern. While the 1.5°C sensitivity analysis suggests a potential $4bn impairment, or 7% reported equity, the scope of this sensitivity is limited to upstream assets and only considers lower commodity prices and higher carbon prices. Taken together, we believe that Equinor's accounts fail to provide a reliable view of the climate risks embedded in the business, providing cover for continued climate harm.

Conclusion

- In summary, while we welcome the improved disclosures relating to climate risks in Equinor's Annual Report & Accounts, and EY's additional audit disclosures, we have questions over critical accounting assumptions, how these are consistent with expected decarbonisation and Equinor's Transition Plan, and how a 1.5°C scenario could impact its financial position.