SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Application of the PEOPLE OF THE STATE OF NEW YORK, by BARBARA D. UNDERWOOD, Attorney General of the State of New York, Petitioner, - against - PRICEWATERHOUSECOOPERS LLP and EXXON MOBIL CORPORATION, Respondents.	Index No. 451962/2016 IAS Part 61 Hon. Barry R. Ostrager Motion Sequence No. 7

OFFICE OF THE ATTORNEY GENERAL'S MEMORANDUM OF LAW IN SUPPORT OF MOTION TO COMPEL COMPLIANCE WITH INVESTIGATORY SUBPOENAS

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The Office of the Attorney General ("OAG") respectfully submits this memorandum of law and the accompanying affirmations of John Oleske ("Oleske Aff.") and Jonathan Zweig ("Zweig Aff.") in support of its motion to compel Exxon Mobil Corporation ("Exxon") to comply with OAG's May 8, 2017 and November 5, 2015 subpoenas by: (i) producing the cash flow projections in the form of spreadsheets and their backup materials ("cash flow spreadsheets") reflecting whether and to what extent Exxon used a proxy cost of greenhouse gas ("GHG") emissions in its investment decisions, corporate planning reviews, company reserves estimates, and impairment evaluations for 26 Exxon assets and projects; and (ii) producing the documents Exxon previously provided to the Securities & Exchange Commission ("SEC") relating to impairment evaluations, reserves calculations, and climate change.

PRELIMINARY STATEMENT

This motion concerns OAG's requests for specific documents that are central to this investigation. That they have not been produced to OAG already is due to Exxon's refusal to collect documents from a limited number of electronic folders where it knows this key evidence is stored. It is also due to Exxon's insistence on litigating the merits of OAG's potential claims before OAG's investigation is complete. But despite Exxon's obstinacy, the factual basis for OAG's investigation has only strengthened since we last were before the Court.

Exxon has repeatedly assured investors that it is taking active steps to protect the company's value from the risk that climate change regulation poses to its business. A key safeguard that Exxon has frequently touted is that it "requires that all [of its] business units" include a proxy cost for GHG emissions in the long-term expense projections that Exxon uses for purposes of investment decision-making, business planning, and financial reporting. (Oleske Aff. ¶ 6.) According to Exxon, these proxy costs, some of which appear in the company's

annual *Outlook for Energy* reports ("Outlook Reports"), as well as other company publications, "reflect[] [Exxon's] best assessment of costs associated with potential GHG regulations over the *Outlook* period," *i.e.*, through 2040 or longer. (*Id.* ¶ 8.) These proxy costs, which rise over time in real dollars, purportedly reflect Exxon's projection that "[g]overnments' constraints on use of carbon-based energy sources and limits on emissions . . . [will] increase throughout the *Outlook* period." (*Id.*) Exxon assured its investors that, based on its risk management practices, and in particular the application of proxy costs, it is "confident that none of [its] hydrocarbon reserves are now or will become 'stranded.'" (*Id.*)

The evidence obtained in the course of OAG's investigation provides substantial reason to believe that Exxon's representations were false and misleading. In its June 9, 2017 response to OAG's previous motion, Exxon first admitted that, for several years, the company maintained an undisclosed corporate policy, documented in the company's Corporate Plan Appendices to the Dataguide ("Corporate Plan"), which directed the use of a second set of proxy costs ("Corporate Plan Proxy Costs") that were significantly lower than those set forth in Exxon's public Outlook Reports ("Outlook Proxy Costs"). Exxon's outside counsel asserted that there is no disconnect between the company's public representations and its internal policy, because (i) the Outlook Proxy Cost described in its public representations is used only for purposes of projecting oil and gas demand, which influences oil and gas price projections and, ultimately, revenue projections, while (ii) the Corporate Plan Proxy Cost is actually a separate "GHG cost" that applies only to projecting Exxon's expenses in connection with its capital investments in oil and gas projects. (*Id.* ¶ 35.) That distinction had not been disclosed in Exxon's *public* representations; those public representations described proxy costs as a single concept, and failed to disclose that the company maintained a second, internal set of proxy costs that were lower, and thus took into

account less risk than the figures described publicly. (*Id.* 23-43.) Accepting, for the purposes of this motion, Exxon's newly explained distinction regarding the purpose of its proxy costs, OAG seeks documents that are likely to reveal whether Exxon adhered to its public, contemporaneous representations that it in fact applied the only proxy costs it described publicly – the Outlook Proxy Costs – in its investment decision-making, business planning, and financial reporting.

There are four independent bases to believe that it did not. First, Exxon's Corporate Plan directed employees to use lower proxy costs for investment decisions in OECD countries than the Outlook Proxy Costs.[1] In mid-2014, after an Exxon employee noted that the company's representations falsely implied that the Outlook Proxy Costs were used for investment decisions, and observed that the lower Corporate Plan Proxy Costs provided less protection to company investments in projects that emitted GHGs, Exxon belatedly conformed some of the Corporate Plan Proxy Cost figures with the Outlook Proxy Costs. (*Id.* ¶¶ 24-28.) Second, for several years, Exxon's Corporate Plan directed employees to omit proxy costs altogether from base economic cost projections in cash flow spreadsheets for projects in non-OECD countries, despite Exxon's public statements that proxy costs would be applied to projects in those same countries. (*Id.* ¶¶ 29-32.) Third, for at least some projects, Exxon apparently still incorporated lower costs than those contained in the Outlook Reports and the revised Corporate Plan even after 2014. For example, Exxon employees apparently were directed by management to use existing, much lower legislated costs in lieu of proxy costs for certain projects and assets in Alberta, Canada, where the provincial government imposes a carbon tax on GHG emissions, and to assume that those costs would remain flat for decades into the future. (*Id.* ¶¶ 45-60.) In so doing, Exxon avoided recognizing the "massive GHG costs" and "large write-downs" that its employees

[1] "OECD" refers to the Organisation for Economic Co-operation and Development, which includes 35 developed and emerging countries as members.

believed would have resulted from applying the schedule of escalating proxy costs set forth in the company's Outlook Reports and in the revised Corporate Plan. (*Id.* ¶¶ 47, 50.) Fourth, the evidence indicates that prior to 2016, Exxon did not include proxy costs in its cost projections for purposes of impairment evaluations. (*Id.* ¶¶ 61-62.)

Exxon's apparent undercounting of projected GHG costs in these four independent ways influenced its core business functions, such as investment decisions, business planning, reserves estimates, and impairment evaluations. Since the beginning of this investigation, OAG has sought documents reflecting whether and to what extent Exxon used proxy costs in those functions. The documents OAG presently seeks – the cash flow spreadsheets and the documents Exxon previously provided to the SEC – are highly relevant to this inquiry. Exxon's witnesses have made clear that Exxon maintains collections of cash flow spreadsheets that would reflect any incorporation of proxy costs into Exxon's investment decisions, corporate planning reviews, company reserves estimates, and impairment evaluations. (Zweig Aff. ¶¶ 33, 39, 41, 49-51, 54, 56-57.)

Indeed, there can be no credible dispute as to the relevance of these documents given that Exxon has produced a number of cash flow spreadsheets, although most in incomplete or draft form, for a few Alberta oil sands projects, as email attachments and other files from individual planners responsible for modeling future conditions and assessing how they affect investment decisions. (*Id.* ¶ 63.) OAG's preliminary analysis of those spreadsheets bears out what Exxon's employees expected – applying the long-term Outlook Proxy Costs (reflected in the revised Corporate Plan) to these projects' economics would have major financial impacts on those investments. (Oleske Aff. ¶ 55.) In the words of Exxon's employees, applying those proxy costs in the cash flow spreadsheets for these projects generated forecasts that would "shorten asset life

and reduce gross reserves" and result in "large write-downs," due to "massive GHG costs in the out years." (*Id.* ¶¶ 47, 50, 57.) Rather than accept these negative financial consequences, Exxon appears to have employed what a planning supervisor called an "alternate methodology" to avoid them. (*Id.* ¶¶ 47-48.) By applying only existing legislated costs (*i.e.*, the price per ton of emissions at that moment under Alberta's regulatory regime) without future escalation, Exxon may have undercounted projected GHG-related costs in the Alberta oil sands by as much as 93%. (*Id.* ¶ 55.) Depending on oil price assumptions, the decision to apply these lower legislated costs in lieu of the proxy costs Exxon represented to investors may have made the difference between positive and negative projected cash flows for at least one major Alberta project. (*Id.* ¶ 56.)

As set out below, the only cognizable grounds for resistance to OAG's authorized subpoenas would be if the requested materials were "utterly irrelevant to any proper inquiry" or "obviously and inevitably futile." (*See infra* at 9.) Here, far from being irrelevant or futile, the requested spreadsheets are highly relevant to whether Exxon applied any proxy cost, what specific cost it applied, and for what period of time it applied such cost. Exxon has cited burden in refusing to produce cash flow spreadsheets for the 26 projects and assets that are among the company's largest and most at risk due to climate change, but Exxon's witnesses have made clear there is little burden associated with producing these cash flow spreadsheets. According to these witnesses, Exxon maintains final versions of its cash flow spreadsheets in centralized, shared locations within its major subsidiaries, to ensure ready access. The spreadsheets are easily identifiable within those files, and a handful of planning supervisors in Exxon's major subsidiaries could readily retrieve them. In rejecting OAG's carefully tailored request, Exxon has demonstrated, once again, that only the Court's compulsion will prompt the company to meet its compliance obligations. Accordingly, OAG requests that the Court order Exxon to produce

the cash flow spreadsheets identified in Exhibit A to the accompanying proposed order.

Separately, although Exxon has provided documents to the SEC regarding its use of proxy costs in the context of asset impairment evaluations and reserves estimates, Exxon continues to resist OAG's request for those documents on purported federal preemption grounds. There is no legal basis to preempt any aspect of OAG's investigation. Indeed, this Court declined to grant Exxon's prior motion on that basis, and instead ordered Exxon to identify employees responsible for estimating reserves and to meet and confer on the document requests in the 2017 Subpoena.[2] In addition, the U.S. District Court for the Southern District of New York recently rejected Exxon's claim that OAG's inquiry was preempted by SEC regulations. *Exxon v. Schneiderman*, No. 17-02301, Slip Op. at 47-48 (S.D.N.Y. Mar. 29, 2018). Exxon is now precluded from arguing otherwise.[3] OAG thus asks the Court to direct Exxon to produce the documents it has provided to the SEC.

It is unfortunate that a motion to compel is necessary to obtain these two categories of plainly relevant documents. But Exxon has gone to extraordinary lengths to delay, disrupt and derail this law enforcement investigation and a similar investigation by the Attorney General of Massachusetts.[4] The federal district court in *Exxon v. Schneiderman* recently dismissed Exxon's claims seeking the "extraordinary" relief of stopping "state officials from conducting duly-authorized investigations into potential fraud," Slip Op. at 1, and held that Exxon's claims were

[2] Exxon previously raised this argument in its May 19, 2017 Motion to Quash the 2017 Subpoena. *See* Exxon Mobil Corporation's Brief in Support of its Motion to Quash and for a Protective Order, May 19, 2017, NYSCEF No. 130, at 19-23.

[3] *See Ball v. A.O. Smith Corp.*, 451 F.3d 66, 69 (2d Cir. 2006); *Browning Ave. Realty Corp. v. Rubin*, 207 A.D.2d 263, 266 (1st Dep't 1994).

[4] The Supreme Judicial Court of Massachusetts recently affirmed a Superior Court's order denying Exxon's motion to set aside or modify a civil investigative demand ("CID") – the Massachusetts analog of an OAG investigative subpoena – and granting the Attorney General's cross-motion to compel Exxon to comply with the CID. *Exxon Mobil Corp. v. Attorney General*, SJC-12376 (Mass. Apr. 13, 2018).

based on "extremely thin allegations and speculative inferences," *id.* at 2. In rejecting Exxon's claim that the documents sought by OAG's subpoenas are purportedly irrelevant to this investigation, the court observed:

> Exxon's attempt to argue relevance in this Court but not in the New York Supreme Court reviewing the Subpoenas smacks of a "have your cake and eat it too" approach. The legal jiu-jitsu necessary to pursue this strategy would be impressive had it not raised serious risks of federal meddling in state investigations and led to a sprawling litigation involving four different judges, at least three lawsuits, innumerable motions and a huge waste of the AGs' time and money.

Id. at 43 n.31.[5]

PROCEDURAL HISTORY

OAG first sought, in the November 2015 subpoena, documents showing whether and how Exxon applied the proxy costs that, according to its representations to investors, it applied in its core business functions. (Zweig Aff. ¶ 3.) Exxon's counsel repeatedly avoided producing documents showing how the company actually applied proxy costs to specific projects by asserting that its *Corporate Plans* "specify precisely how ExxonMobil applies its *proxy cost* of carbon in every jurisdiction worldwide through the year 2040." (Oleske Aff. ¶ 42.) (Emphasis added.)

Then, in the May 2017 subpoena, OAG reiterated its request for key proxy cost data from Exxon's cash flow spreadsheets, and called for production of the underlying documents. (Zweig Aff. ¶ 14.) Exxon refused and moved to quash. OAG opposed Exxon's motion to quash and cross-moved to compel compliance with OAG's 2015 and 2017 subpoenas. In response, Exxon articulated a new position flatly contradicting its former position, now asserting that the Corporate Plans do not contain "proxy costs," but rather "GHG costs," with "proxy costs"

[5] Exxon has now filed a notice of appeal of the district court's dismissal.

incorporated only in the Outlook Reports. (Oleske Aff. ¶¶ 35-44.)

At the June 16, 2017 conference, the Court granted in part OAG's cross-motion to compel, ordering Exxon to produce a witness for testimony from Exxon's Imperial Oil Limited ("Imperial") subsidiary, and to produce documents created in 2016 that were responsive to the 2015 subpoena. The Court rightly predicted that such testimony would reveal whether there were categories of responsive documents that Exxon should have previously produced, and made clear that OAG has "the authority to ask for additional documents." (Zweig Aff. ¶ 18.) The Court did not grant Exxon's motion to quash, and instead directed Exxon and OAG to meet and confer on OAG's remaining requests. (*Id.*) Thereafter, OAG repeatedly offered to limit its requests for cash flow spreadsheets to a narrow group of Exxon's major projects, most recently offering to limit its request to the cash flow spreadsheets for only 26 of Exxon's many hundreds of oil and gas projects and assets. (Zweig Aff. ¶¶ 21-42; Oleske Aff. ¶¶ 67-68.)

Exxon rejected OAG's narrowed requests. As to cash flow spreadsheets, Exxon insisted that OAG further restrict its already limited request to an even smaller subset of projects that did not include cash flow spreadsheets concerning: (i) any projects or assets in non-OECD countries; (ii) any downstream (*e.g.*, refining) and chemical projects or assets; (iii) any evaluation of existing assets for potential impairment; (iv) any assessment of Exxon's company reserves and resource base; (v) any upstream projects or assets in the exploration phase (*i.e.*, those supervised by ExxonMobil Exploration Company) or the production phase (*i.e.*, those supervised by ExxonMobil Production Company); (vi) any projects or assets supervised by XTO Energy, Inc. ("XTO")[6]; and (vii) any assessment of Exxon's 2010 purchase of XTO for over $40 billion in equity. (Zweig Aff. ¶ 22.) Each of these areas involves projects and assets with ongoing

[6] XTO is an Exxon subsidiary that focuses on unconventional oil and gas resources and operates primarily in North America.

investments and substantial GHG emissions. Exxon also refused to produce the readily available documents it provided to the SEC. (Oleske Aff. ¶ 74.)

ARGUMENT

The Court reviews the enforceability of OAG's subpoenas for their (1) reasonable relationship to; (2) an authorized investigation; (3) that is grounded in an articulable factual basis. *Am. Dental Coop., Inc. v. Attorney-General,* 514 N.Y.S.2d 228, 232 (1st Dep't 1987) (OAG need only show "some factual basis for [the] investigation" and "the relevance of the items sought"). Exxon must show that "the *futility* of the process to uncover anything legitimate *is inevitable or obvious* or . . . the information sought is *utterly irrelevant* to any proper inquiry." *Anheuser-Busch, Inc. v. Abrams*, 71 N.Y.2d 327, 332 (1988) (emphasis added). In particular, it is Exxon's burden to show such "obvious futility" or "utter irrelevance" by competent evidence, not unfounded allegations or attorney argument. *Hogan v. Cuomo,* 888 N.Y.S.2d 665, 667 (3d Dep't 2009). Exxon must overcome a presumption that OAG's asserted factual bases and particular requests reflect the good faith execution of its mandate from the Legislature to enforce State anti-fraud laws.[7] *Id.*; *Am. Dental Coop.*, 514 N.Y.S.2d at 232.

This standard applies no less to follow-up requests than those made at the outset of an investigation. *See Horn Constr. Co. v. Fraiman*, 309 N.Y.S.2d 377, 379-80 (1st Dep't 1970) (even "after extensive examination of witnesses," State need only show a "reasonable relationship" between subsequent document requests and objective of investigation). Even in the context of an ongoing inquiry, "[t]he Attorney-General is not required to disclose the probable

[7] *See* N.Y. Gen. Bus. Law § 352 ("Whenever it shall *appear to [OAG]*, . . . that any . . . corporation . . . shall have employed . . . any deception . . . [it] may in [its] discretion . . . require . . . a statement [and] such other data and information as [it] may deem relevant . . . subpoena witnesses . . . and require the production of any books or papers *which [it] deems relevant or material to the inquiry.*") (emphasis added); N.Y. Exec. Law § 63(12) (OAG "is authorized to take proof and make a determination of the relevant facts and to issue subpoenas").

cause and scope of his investigation to justify the issuance of a subpoena. A subpoena issued in the course of an ongoing investigation is prima facie adequate without further amplification or justification." *Hirschorn v. Attorney General*, 93 Misc. 2d 275, 277 (Sup. Ct. N.Y. Cnty. 1978). Further, it is commonplace, and entirely appropriate, to supplement productions resulting from the application of search terms to the electronic files of document custodians with the production of specific relevant documents. *See, e.g.*, *Fort Worth Emps. Ret. Fund v. J.P. Morgan Chase & Co.*, 297 F.R.D. 99, 109-14 (S.D.N.Y. 2013).

Here, the requested documents unquestionably bear a reasonable relationship to an authorized investigation that is grounded in an articulable factual basis. The cash flow spreadsheets and documents produced to the SEC are directly relevant to the core issues concerning the accuracy of Exxon's public representations—the extent to which Exxon applied a proxy cost in making its investment decisions, conducting corporate planning reviews, estimating company reserves, and conducting asset impairment evaluations.

A. OAG's Investigation Rests on a Solid Factual Basis

As described below and in the accompanying affirmation of John Oleske, OAG's investigation and the specific requests in this motion rest on a solid factual basis, supported by documents and testimony collected to date.[8]

1. Exxon's Public Representations About Proxy Costs

In response to growing investor concerns about the risks that potential climate change regulations could pose to its business, Exxon repeatedly pointed investors to its use of a "proxy

[8] OAG's prior motion to compel, *see* NYSCEF Doc. 169, set forth the basis for OAG's investigation at that time, and was based on Exxon's factual representations to OAG and to this Court and OAG's then-current review of the evidence. That motion should not be understood as representing the current status of OAG's investigation, and is superseded by the current motion to compel. The current motion reflects facts and evidence not available to OAG at the time of the earlier motion, as well as Exxon's shifting factual representations to the OAG and to this Court. OAG also continues to investigate potential misrepresentations by Exxon that are not the focus of the present motion, and which are not detailed in the accompanying affirmation.

cost" that reflects how potential GHG-related costs imposed by *future* climate regulations may affect its long-lived oil and gas assets. Exxon further claimed that it addressed the risks of such government action by using a proxy cost in its investment decisions and business planning as part of a purportedly "consistent corporate planning basis." (Oleske Aff. ¶ 6.)

In March 2014, Exxon issued two reports in response to proposed shareholder resolutions that requested detailed financial analyses of the company's resilience to increased regulatory costs relating to efforts to combat climate change. (*Id.* ¶ 5.) These reports claimed that Exxon "require[d] that investment proposals reflect the climate-related policy decisions we anticipate governments making during the *Outlook* period and therefore incorporate them as a factor in our specific investment decisions." (*Id.* ¶ 8.) The reports specifically touted the company's "require[ment]" that "all business units" use the proxy cost featured in the Outlook Reports "in evaluating capital expenditures and developing business plans," and making "specific investment decisions." (*Id.* ¶ 6.) Exxon asserted that "this GHG proxy cost is integral to [its] planning." (*Id.*) Exxon concluded, based in part on its use of a proxy cost in its investment decisions and business planning, that none of the company's reserves are now or will become "stranded," and that the company's ongoing investments in new reserves are also not exposed to the risk of becoming stranded. (*Id.* ¶ 8.)

The reports did not disclose what Exxon now asserts: that Exxon in fact had two different sets of proxy costs – Outlook Proxy Costs, which Exxon now refers to as "proxy" costs, and Corporate Plan Proxy Costs, which Exxon now refers to as "GHG" costs. Rather, Exxon described its proxy cost as a single concept, intended to reflect the company's best estimate of projected emissions costs in each jurisdiction, and applied as part of a "consistent corporate planning basis." (*Id.* ¶ 6.) Notwithstanding Exxon's current position, the terms "proxy" and

"GHG" in no way distinguished these costs in Exxon's public representations; even accepting Exxon's explanation that the Outlook Proxy Costs and Corporate Plan Proxy Costs are used for different purposes, they both are a *proxy* for projected future costs of *GHG* emissions. Exxon even conflated the concepts by using the term "GHG proxy cost," as described above. (*Id.* ¶¶ 35-43.) Indeed, Exxon's GHG Manager later observed that, in those reports, "[w]e have implied that we use the EO [*i.e.*, Energy Outlook] basis for proxy cost of carbon when evaluating investments." (*Id.* ¶ 25.)

These reports also make clear that Exxon was not assuming that existing, legislated costs would remain in place indefinitely. Rather, Exxon explicitly described its proxy cost as incorporating the company's assumption – consistent with those of the concerned shareholders – that "[g]overnments' constraints on use of carbon-based energy sources and limits on [GHG] emissions . . . [will] increase throughout the *Outlook* period." (*Id.* ¶ 8.) Exxon specified that it expected "OECD nations" – like Canada – "[to] continu[e] to lead the way," and that non-OECD countries like China would impose lower, but similarly escalating costs on GHG emissions over that period. (*Id.* ¶ 7.)

Exxon repeatedly quoted from and referred investors to its March 2014 reports in proxy statements, annual reports, and Corporate Citizenship Reports. (*Id.* ¶ 10.) In so doing, the company continued to tout its use of a proxy cost in its "planning" and "model[s]" for the purpose of testing potential investments against anticipated climate change regulations, and as a risk-management safeguard that was "integral to [Exxon's] planning." (*Id.* ¶¶ 6-10.) None of these disclosures identified the existence of the Corporate Plan Proxy Costs, distinguished those costs from the Outlook Proxy Costs, or revealed that, for a period of time, the Corporate Plan Proxy Costs were substantially lower than the Outlook Proxy Costs.

Moreover, Exxon publicly claimed that its Outlook Proxy Cost had been in use since 2007. For example, a December 2, 2015 publication on Exxon's corporate website, entitled *ExxonMobil and the carbon tax*, specified that the company "ha[d] included a proxy price on carbon in [its] business planning since 2007," in order "to analyze the impact of a price on carbon on various investment opportunities." (*Id.* ¶ 12.) These statements assured investors that Exxon's many billions of dollars in capital expenditures since 2007 had been risk-managed using proxy costs—without distinguishing between Outlook and Corporate Plan Proxy Costs.

Then, at Exxon's May 2016 annual shareholder meeting, the company's then-Chairman and CEO Rex Tillerson reassured the company's investors of the general application of proxy costs in Exxon's investment decisions:

> We have, unlike many of our competitors, we have for many years included a price of carbon ***in our outlook***. ***And that price of carbon gets put into all of our economic models when we make investment decisions as well. It's a proxy.*** We don't know how else to model what future policy impacts might be. But whatever policies are, ultimately they come back to either your revenues or your cost. So we choose to put it in ***as a cost***. So we have accommodated that uncertainty in the future, and ***everything gets tested against it***.

(*Id.* ¶ 13.) Mr. Tillerson's assertion that Exxon's Outlook Proxy Costs are incorporated "as a cost," rather than as a factor affecting revenues, is directly contrary to Exxon's current position that Outlook Proxy Costs relate only to Exxon's demand and revenue projections.[9]

2. Exxon's Public Representations About Resources, Reserves and Impairment

Exxon has also represented that the company's financial prospects are strong due in

[9] In February 2018, after OAG's June 2017 motion to compel revealed the discrepancy between Exxon's Corporate Plan Proxy Costs and the Outlook Proxy Costs, the company issued a new report on energy and carbon that contained a new disclosure on proxy costs. In that report, Exxon attempted—for the first time, apart from its court papers in this matter—to describe a distinction between the scope and use of its external Outlook "proxy costs" and its internal Corporate Plan "GHG costs," using language that closely tracks its court papers from last June. (Oleske Aff. ¶ 44.)

significant part to the size of its resource base, which is estimated as part of its "company reserves" process. (*Id.* ¶ 14-19.) Exxon has publicly disclosed the size of that resource base—which is far larger than and distinct from the proved reserves reported in its financial statements—and which comprises "quantities of oil and gas that are not yet classified as proved reserves under SEC definitions, but that [Exxon] believe[s] will ultimately be developed." (*Id.* ¶ 14.) Exxon has told investors that its company reserves and resource base estimates are "aligned with" industry guidelines that require a company to apply "a consistent set of forecast conditions, including assumed future costs and prices" to all calculations, based on the company's own view of future conditions. (*Id.* ¶¶ 16-17.) The proxy cost of GHG emissions that Exxon purportedly utilizes is quintessentially an "assumed future cost[]." (*Id.* ¶¶ 17-18.) Applying a proxy cost to company reserves estimates may render certain high-emissions resources uneconomical to extract and result in their removal from Exxon's resource base. (*Id.* ¶ 19.) Failing to include proxy costs in those estimates may accordingly render them misleading.

Likewise, Exxon has represented in its annual report to investors that, consistent with generally accepted accounting principles ("GAAP"), its asset impairment evaluations used "cost assumptions" that were "developed in the annual planning and budgeting process," and were "consistent with criteria management uses to evaluate investment opportunities." (*Id.* ¶ 20.) These representations may be misleading if Exxon did not incorporate proxy costs in its impairment evaluations in the manner that it used, or purported to use, those costs in its investment decision-making and business planning.[10]

[10] Documents and testimony also indicate that Exxon's company reserves estimates are an input into its impairment evaluations, so failing to include proxy costs in those estimates would also call into question the accuracy of Exxon's impairment-related representations. Oleske Aff. ¶¶ 21-22.

3. OAG's Investigation Has Revealed That Exxon's Internal Practices May Not Have Conformed to Its Public Representations

a. Exxon's Apparent Use of Corporate Plan Proxy Costs

For many years, Exxon concealed from the public that it maintained a second set of proxy costs, separate from the figures that it disclosed to the public in its annual Outlook Reports, and implied that the costs set forth in the Outlook Reports were the same as those used in making cost projections for investment decisions. Exxon's undisclosed Corporate Plan Proxy Costs deviated from its publicly disclosed Outlook Proxy Costs in two ways. First, from at least 2010 through mid-2014, Exxon's Corporate Plan directed the use of cost figures for projects in OECD countries that were significantly lower than the Outlook Proxy Costs. For example, in 2010, Exxon publicly represented that its Outlook Proxy Cost for OECD countries was $60/ton of emissions in 2030, while, internally, its undisclosed Corporate Plan Proxy Cost was only $40/ton in 2030. (*Id.* ¶ 24.) In 2012 and 2013, Exxon publicly represented that its Outlook Proxy Cost was $60/ton in 2030, as before, and $80/ton in 2040. (*Id.*) Internally, Exxon's Corporate Plan Proxy Cost still reached only $40/ton by 2030 for OECD countries, and did not even extend to 2040. (*Id.*)

In May 2014, Exxon's GHG Manager recommended in a presentation to Exxon management that the proxy cost figures in the Outlook Reports and Corporate Plans be aligned, noting that the company's March 2014 reports to shareholders "implied that we use the [Outlook] basis for proxy cost of carbon when evaluating investments." (*Id.* ¶ 25.) The GHG Manager also noted, as his predecessor had recognized as early as 2011, that the lower Corporate Plan Proxy Costs were "non-conservative" (*i.e.*, riskier) in comparison to the Outlook Proxy Costs for projects that created GHG emissions, as opposed to investments in projects to reduce emissions. (*Id.*) One month later, Exxon aligned the long-term Corporate Plan Proxy Costs with

the proxy costs in the Outlook Reports, but for OECD countries only. (*Id.* ¶ 27.)

Second, between at least 2012 and 2016, the Corporate Plan also directed planners not to use *any* proxy costs in the base economic cost projections in the cash flow spreadsheets used for investment and planning purposes for projects in non-OECD countries,[11] despite public representations in the Outlook Reports that proxy costs were being applied to projects in those countries. (*Id.* ¶ 29.) Not until 2016 did Exxon align the long-term Corporate Plan Proxy Costs for non-OECD countries with the relevant Outlook Proxy Costs. (*Id.* ¶ 32.)

b. Exxon's Apparent Use of Existing Legislated Costs in Lieu of Proxy Costs

Documents also indicate that even after Exxon aligned the long-term Corporate Plan Proxy Costs for OECD countries with its Outlook Proxy Costs in June 2014, Exxon's planners responsible for the company's vast investments in the oil sands fields of Alberta encountered adverse financial results when they tried to apply those costs. These planners observed that applying the now-aligned long-term proxy costs in the cash flow spreadsheets for these projects generated forecasts that would, in their own words, "shorten asset life and reduce gross reserves" and result in "large write-downs," due to "massive GHG costs in the out years." (*Id.* ¶¶ 47, 50, 57.) Rather than accept the negative implications of these projections, Exxon appears to have employed what a planning supervisor called an "alternate methodology" to avoid them. (*Id.* ¶ 47.)

Under this "alternate methodology," it appears that Exxon did *not* use the Outlook and Corporate Plan Proxy Costs in its cost projections in the cash flow spreadsheets for these

[11] This was subject only to an exception by which planners could include such costs as part of a sensitivity analysis for projects in certain non-OECD countries. [redacted]

projects. Instead, Exxon substituted figures reflecting only the existing, legislated costs for GHG emissions then imposed by the Alberta government. (*Id.* ¶¶ 45-59.) Further, Exxon apparently assumed that those regulatory costs would remain constant for all future years (often multiple decades) of the assets' projected operations. (*Id.*) This assumption directly contradicts Exxon's public representations that it expected the costs associated with GHG emissions to increase over the long-term period described in the Outlook Reports, and over which Exxon expects many of its projects to operate. (*Id.* ¶ 8.)

Notwithstanding Exxon's refusal to produce the cash flow spreadsheets that it actually used for investment, planning, and financial reporting purposes, a limited number of cash flow spreadsheets (mostly incomplete and/or draft versions) relating to the Alberta oil sands projects have been produced from the custody of a few of the company's project planners. (Zweig Aff. ¶ 63.) Based on OAG's preliminary analysis of those spreadsheets, by not applying the Outlook and Corporate Plan Proxy Costs for these projects in the company's cost projections, Exxon's calculations may have undercounted projected GHG-related expenses by as much as 93%, and, depending on oil price assumptions, allowed Exxon to avoid projections of negative future cash flows and potential reductions in associated company resources and reserves. (Oleske Aff. ¶ 55.)

c. Exxon's Apparent Failure to Use Proxy Costs in Company Reserves Estimates or Impairment Evaluations

Finally, Exxon may not have abided by its public representations or Corporate Plan with respect to company reserves estimates and impairment evaluations. Documents indicate that the cost projections associated with Exxon's company reserves estimates do not incorporate proxy costs, calling into question (i) the company's public estimates of a substantial resource base well beyond its proved reserves reported under SEC regulations, (ii) the company's representations that its reserves and resource base estimates followed industry guidelines, and (iii) the

impairment assessments directly affected by those estimates. (*Id.* ¶¶ 61-62.) Testimony and documents produced by Exxon and its external auditor, PricewaterhouseCoopers LLP ("PwC"), also indicate that proxy costs were not included in Exxon's cost projections relating to impairment evaluations prior to 2016. (*Id.*) This calls into question Exxon's representations that the assumptions used in the company's impairment evaluations are consistent with those purportedly used in its investment decisions and business planning. (*Id.* ¶¶ 20-22.)

B. The Requested Documents Are Reasonably Related to OAG's Investigation

The requested documents are not only reasonably related to its investigation, but are highly relevant to the issue of whether and to what extent Exxon adhered to its public representations regarding the use of proxy costs in its core investment and financial decisions.

1. Cash Flow Spreadsheets

a. The Requested Cash Flow Spreadsheets Are Highly Relevant

The requested cash flow spreadsheets are highly relevant to OAG's investigation. Cash flow spreadsheets, also referred to by company planners as economic models, are documents that set forth Exxon's projections with respect to the revenues and profitability of its projects and assets, and the factors that influence revenues and profits. These factors include, for example, projected oil and gas production, oil and gas prices, capital expenditures, operating expenditures, and, to the extent they were incorporated, proxy costs. These projections generally represent Exxon's best estimates of future economic conditions, and are central to core decision-making, planning, and reporting processes at Exxon. (*Id.* ¶ 63.) Exxon employees routinely used cash flow spreadsheets to evaluate new and ongoing investments, submit materials for corporate planning reviews, estimate company reserves, and evaluate assets for impairment. (*Id.* ¶ 64.)

Cash flow spreadsheets likely provide the most direct evidence of what proxy costs, if any, Exxon used, as well as the financial impact of any failure to abide by the company's public

representations. [redacted] (*Id.* ¶ 65.) While some cash flow spreadsheets are presented in a summary format, Exxon's witnesses have testified that such summaries are supported by backup materials, such as input files, that contain more specific information, including any specific proxy cost figures that Exxon applied. (*Id.* ¶¶ 69-70.)

The cash flow spreadsheets Exxon has produced for a few projects and assets raise serious questions about the company's compliance with its proxy cost-related representations, as described above. Yet, despite their indisputable relevance, Exxon's production of cash flow spreadsheets has been extremely limited. Nearly all cash flow spreadsheets Exxon has produced relate to oil sands projects in Alberta and do not include, for example, information about Exxon's projects and assets in other parts of the world, or Exxon's downstream or petrochemical projects and assets. Moreover, Exxon has not produced cash flow spreadsheets from its centralized files of final cash flow spreadsheets used for company decision-making, as described by Exxon's witnesses. (Zweig Aff. ¶ 48-65.) Rather, the only cash flow spreadsheets Exxon has produced are those that happen to be attached to emails or located in personal computer files of certain custodians. (*Id.* ¶ 63.) For this reason, most of the produced spreadsheets appear to be draft and/or incomplete versions.[12] (*Id.*)

Other sources of evidence cannot replicate the key information contained in cash flow spreadsheets. [redacted] (Oleske Aff. ¶ 66.) [redacted]

[12] The cash flow spreadsheets Exxon has produced are also limited to those that include GHG-related search terms, meaning that spreadsheets reflecting Exxon's failure to include proxy costs would generally not be included.

[redacted] (*Id.*) [redacted] (*Id.*) The final spreadsheets likely contain the most reliable evidence of what proxy costs, if any, Exxon actually used.

b. There Is No Undue Burden

Exxon cannot refuse production of the requested documents on grounds of undue burden. It is "[r]elevancy, and not quantity," that determines "the validity of a subpoena." *See Am. Dental Coop.*, 514 N.Y.S.2d at 234. *See also City of Albany Indus. Dev. Agency v. N.Y. State Comm'n on Gov't Integrity,* 144 Misc. 2d 342, 344-45 (Sup. Ct. Albany Cnty. 1989) ("searching through 'hundreds of thousands' of documents," in an investigation that was already "well underway" was not unduly burdensome); *Gelb v. Kuriansky*, 118 Misc. 2d 960, 962 (Sup. Ct. Kings Cnty. 1983) ("[t]he problem of volume" is "inherent to investigations involving . . . extensive business operations"; parties operating "extensive" businesses "cannot complain of the magnitude of their own operation as a basis for resisting compliance with otherwise lawful subpoenas"); *FTC v. Texaco, Inc.*, 555 F.2d 862, 882 (D.C. Cir. 1977) (enforcing investigative subpoena concerning hundreds of gas fields when "the breadth complained of is in large part attributable to the magnitude of the producers' business operations"). Exxon cannot plausibly argue that compliance "threatens to unduly disrupt or seriously hinder normal operations of [its] business." *NLRB v. Am. Med. Response, Inc.*, 438 F.3d 188, 193 n.4 (2d Cir. 2006).

OAG has limited its requests for cash flow spreadsheets to 26 of Exxon's projects and assets that are among the company's largest and potentially vulnerable to climate change risk. (Oleske Aff. ¶ 67.) This selection targets important areas of investigation, including (1)

upstream, downstream, and chemical operations; (2) projects and assets in OECD and non-OECD jurisdictions; and (3) long-established assets subject to ongoing evaluation, recently completed projects, and projects in development. Exxon has refused to produce cash flow spreadsheets for even this limited subset of projects and assets, out of the many hundreds of assets in Exxon's portfolio.[13]

Exxon's grossly inadequate offer to produce only "documents sufficient to show the manner in which GHG costs were applied" for a "small subset" of upstream projects housed in Exxon's Development Company (*see* Zweig Aff. ¶ 32) would exclude cash flow spreadsheets concerning (i) any projects or assets in non-OECD countries; (ii) any downstream (*e.g.*, refining) and chemical projects or assets; (iii) any evaluation of existing assets for potential impairment; (iv) any assessment of Exxon's company reserves and resource base; (v) any upstream projects or assets in the exploration phase (*i.e.*, those supervised by ExxonMobil Exploration Company) or the production phase (*i.e.*, those supervised by ExxonMobil Production Company); (vi) any projects or assets supervised XTO; and (vii) any assessment of Exxon's 2010 purchase of XTO for over $40 billion in equity (*see id.* ¶ 22). The documents and testimony OAG has obtained raise serious questions about whether, and to what extent, Exxon applied proxy costs in all of these areas. Exxon's public representations about its application of proxy costs were not limited to non-XTO upstream projects in development in OECD countries; OAG's investigation cannot be so limited.

Exxon's argument that producing these spreadsheets would be unduly burdensome is completely undermined by the testimony of its own witnesses. Contrary to Exxon's repeated assertions, Exxon employees have testified that the company in fact maintains final, complete

[13] Exxon has produced cash flow spreadsheets associated with two of these 26 projects and assets, but they were not produced from Exxon's centralized files of final cash flow spreadsheets.

cash flow spreadsheets in a limited number of "centralized" locations, in an organized and readily accessible manner. (*Id.* ¶¶ 33, 39, 41, 48-50, 53, 55-56.) For example, according to documents and testimony, ExxonMobil Development Company ("EMDC"), the Exxon subsidiary that is responsible for many of the company's major upstream projects (and 14 of the 26 projects and assets requested on this motion), maintains a well-organized archive of final cash flow spreadsheets. (*Id.* ¶¶ 33, 39, 41, 49-56.) [redacted] (*Id.* ¶¶ 50-51.) Because of the organization of these files, Exxon employees are able to retrieve the cash flow spreadsheets associated with a specific project when asked to do so. (*Id.* ¶¶ 37, 39, 48-60, 62.) Yet when OAG pressed Exxon about the likely existence of additional responsive documents in the EMDC SharePoint, Exxon falsely assured OAG that it had "no reason to believe [the SharePoint] contain[s] unique responsive documents." (*Id.* ¶ 13.)

Likewise, documents and testimony make clear that cash flow spreadsheets used for investment purposes by other Exxon business units, and those used for corporate planning reviews and company reserves estimates, are organized in readily accessible files. (*Id.* ¶¶ 51, 56-60.) The cash flow spreadsheets used for impairment decisions are also located in a few centralized locations, including [redacted]. (*Id.* ¶ 57.) Key inputs and other backup documents are also included in the same organized filing system. (*Id.* ¶¶ 54-55.)

The lack of undue burden associated with collecting cash flow spreadsheets is also

demonstrated by documents and testimony concerning an Exxon group called [redacted], which collected, evaluated, and graded Exxon's cash flow spreadsheets for projects and assets around the world in [redacted]. (*Id.* ¶ 62.) [redacted] likewise retrieved specific cash flow spreadsheets when they were requested by Exxon's [redacted]. (*Id.* ¶ 55.) Exxon has also provided certain impairment-related cash flow spreadsheets to [redacted] within days of [redacted] requests. (*Id.* ¶ 58.) Exxon's collection of cash flow spreadsheets for its own purposes belies its argument that it cannot do so to comply with OAG's subpoenas.

The Court has made clear that if Exxon is aware of relevant documents in a specific computer folder, it must produce them. (*Id.* ¶ 18.) Here, despite the fact that these cash flow spreadsheets are directly relevant to key issues in this investigation, Exxon continues to withhold them.

2. Exxon's Production to the SEC

The documents Exxon has produced to the SEC are reasonably related to OAG's investigation because they concern Exxon's disclosures and analyses concerning climate change, including documents relating to the company's Outlook Reports and its internal assessments of the impact of climate change on Exxon's company reserves estimates, impairment evaluations, asset recoverability analyses, and energy demand projections. (Oleske Aff. ¶¶ 72-74.) Exxon has not contested the relevance of these documents, but refuses to produce them on the ground that OAG's request is somehow preempted by SEC regulations governing reporting of proved reserves. (*Id.* ¶ 74.)

At the June 16, 2017 conference, this Court implicitly rejected Exxon's preemption argument regarding reserves when it compelled Exxon to identify employees who were responsible for reserve calculations and to meet and confer on the remaining requests in the 2017 subpoena. In addition, the Court noted that arguments on the merits of potential claims or

defenses are not relevant to the enforceability of a pre-complaint investigative subpoena.[14] *See also Endicott Johnson Corp. v. Perkins*, 317 U.S. 501, 509 (1943) (merits arguments cannot "be accepted as a defense against [an investigative] subpoena"). This principle equally applies to preemption defenses. *See Oncor Commc'ns v. State*, 636 N.Y.S.2d 176, 178 (3d Dep't 1996) ("[A]bsent a complaint . . . there can be no meaningful consideration of the preemption issue."). Additionally, the federal district court expressly rejected Exxon's preemption claim in its recent decision dismissing Exxon's challenge to OAG's investigation. *Exxon v. Schneiderman*, No. 17-02301, Slip Op. at 47 ("Exxon's preemption claim [fares] no better. Ordinarily, an action to enforce or quash a subpoena is not the proper forum in which to assert a preemption defense. . . . AGs [] are afforded latitude to conduct their investigations without interference and anticipatory jurisdictional challenges."). The district court's dismissal of Exxon's preemption argument now precludes Exxon from asserting the same argument in this action under principles of issue preclusion. *See Ball v. A.O. Smith Corp.*, 451 F.3d 66, 69 (2d Cir. 2006); *Browning Ave. Realty Corp. v. Rubin*, 207 A.D.2d 263, 266 (1st Dep't 1994).

Exxon's preemption argument is also meritless.[15] OAG's investigation concerns, among other things, the accuracy of Exxon's public representations about its company reserves estimates and resource base, not the proved reserves disclosures that are the subject of the SEC regulations. While the SEC's reporting rules for proved reserves mandate the use of fixed

[14] The Court declined to resolve Exxon's merits arguments on the previous motion, and similarly need not resolve such issues on this motion. *See* June 21, 2017 Order Tr. 17:14-26 ("[OAG]: [T]his is not a merits dispute. The posture we are in on subpoena compliance in a law enforcement investigation does not allow for the weighing of merits disputes. [THE COURT]: I completely and totally agree.").

[15] *See* June 2, 2017 OAG Opp. Br. at 19-21, NYSCEF No. 169; *see also Exxon v. Schneiderman*, No. 17-02301, Slip Op. at 47-48 ("Exxon has pointed to no provision of the SEC regulations that purports to prohibit the AGs from requesting documents that relate to the accounting for reserves. . . . Moreover, Exxon's internal documents regarding reporting of reserves may be relevant to any number of theories, including, for example, whether Exxon understood the science of climate change in fundamentally different ways than it told its investors and the public.").

assumptions for price and cost, the "company reserves" process that generated Exxon's public estimates of its resource base purportedly rely on the company's own price and cost assumptions—including assumptions about the future cost of GHG emissions (*i.e.*, proxy cost). Moreover, the SEC's proved reserves reporting regulations[16] in no way demonstrate a "clear and manifest" intent to supplant state law.[17]

CONCLUSION

For the reasons set forth above, OAG respectfully requests the Court to compel Exxon to produce (i) the cash flow spreadsheets for the 26 projects and assets identified by OAG; and (ii) the documents Exxon has produced to the SEC relating to impairment evaluations, reserves calculations, and climate change.

[16] *See* 17 C.F.R. §§ 210.4-10, 229.1202. Indeed, those regulations expressly state that companies may disclose estimates of oil and gas resources other than the reserves calculations that they mandate, if such disclosure is required by state law. Instruction to 17 C.F.R. § 229.1202 (Item 1202).

[17] *People v. Applied Card Sys., Inc.*, 11 N.Y.3d 105, 113 (2008) ("clear and manifest" intent required to preempt state law); *Cuomo v. Dreamland Amusements, Inc.*, 22 Misc. 3d 1107(A), 2009 N.Y. Slip. Op. 50062(U), at *3 (Sup. Ct. N.Y. Cnty. Jan. 6, 2009) (OAG's subpoena not preempted when federal law in question had not previously been "recognized as completely preemptive").

Dated: New York, New York
June 19, 2018

Respectfully submitted,

BARBARA D. UNDERWOOD
Attorney General of the State of New York

By: _____
John Oleske
Senior Enforcement Counsel

Mandy DeRoche
Assistant Attorney General

Jonathan Zweig
Assistant Attorney General

28 Liberty Street
New York, New York 10005
(212) 416-8660

Attorneys for Petitioner
People of the State of New York

Of Counsel:

MANISHA M. SHETH
Executive Deputy Attorney General, Economic Justice Division

LEMUEL M. SROLOVIC
Bureau Chief, Environmental Protection Bureau