Almost Paradise – The Evolution of ESG in the Energy Industry

E&Ps, Midstreamers and Refiners Implementing Strategies to Reduce GHGs

- **Many investors, lenders and others have come to expect energy companies to develop ESG strategies –– and the vast majority have.**
- **Support for the ESG movement is far from universal, however, with some criticizing it as greenwashing and others alleging it's being used to divert attention from poor business performance.**
- **Also, the push by policymakers and environmental activists to reduce greenhouse gas emissions quickly and significantly is being questioned in the face of a global energy-supply crisis.**
- **There also are questions about the ability of the EPA and other U.S. regulators to implement climate-related rules without clear direction from Congress, and about the ability of Congress to agree on anything substantive.**
- **In a similar vein, the SEC is facing blowback to its proposal to require all publicly held companies to report their GHG emissions and obtain independent certification of their estimates.**
- **California — long a leader on climate issues — is concerned that its renewables-heavy power-generation fleet may be unable to meet high demand and is weighing a plan to maintain the availability of gas-fired plants that had been slated for retirement.**

1. Introduction

Over the past several years, the simultaneous drives for action on climate change, diversity in the workplace, and corporate accountability have coalesced into the environmental, social, and governance (ESG) movement. The energy industry has been at the center of all this, of course, because significant volumes of greenhouse gases (GHGs) are generated with the production, processing, transportation and –– especially — consumption of hydrocarbons. By now, most exploration-and-production companies, oilfield service firms, midstreamers and refiners have developed ESG strategies in which they detail their efforts to reduce emissions of carbon dioxide, methane and other GHGs and make other improvements in their environmental performance, and to ramp up their efforts on the social and governance fronts.

But the ESG movement has also come under increasing scrutiny and criticism — and from all sides, it seems. Advocates of more aggressive climate action have asserted that ESG programs by many hydrocarbon-focused energy companies are little more than greenwashing, a subterfuge designed to soften the skepticism among ESG-minded investors and lenders and the general public about their industry and its activities and products.

Among investors, lenders and policymakers, there are legitimate questions about the degree to which the claims of environmental progress by energy companies are vetted — in other words, how do we know if their purported gains are real, or go beyond what companies are required to do by law? Also, a number of recent studies have suggested that ESG-focused mutual funds and exchange-traded funds (ETFs) underperform the broader market; that many companies touting their ESG cred have less-than-stellar records on compliance with environmental and labor laws; and that some companies use ESG as a cover for poor business performance.

As for energy companies themselves, many are surely making honest, earnest efforts to reduce flaring, minimize methane releases and make their operations more efficient and cleaner. Just as surely, some in the industry believe that a lot of ESG is very "squishy" or even bunk, but think they need to "play along" to appease hydrocarbon-wary investors and lenders and/or show the general public (and politicians and regulators) that they "get it."

Amid all this, the ESG movement is being impacted by, among other things, the Biden administration's push for a faster-paced decline in GHGs; the Securities and Exchange Commission's (SEC) controversial proposal to require all publicly traded companies to report their GHG emissions (and obtain independent certification of their estimates); and — most important, perhaps — the ongoing upheaval in global energy markets, which has led many countries (especially in Europe, but also elsewhere) to examine how quickly they can decarbonize their economy while ensuring energy security and affordability.

There also are indications that U.S. policymakers may need to slow the pace of the energy transition. In June 2022, the Supreme Court scaled back the Environmental Protection Agency's (EPA) authority to implement GHG-reduction rules similar to the ones the Obama EPA put forth a few years ago in its Clean Power Plan. That suggests that Congress would need to reach a compromise on climate goals (and how to achieve them) before federal regulators could do much more to ratchet down GHG emissions from the power-generation sector and other key parts of the economy. (Who among us would place a big bet on Congress compromising on such a politically charged topic?)

Even among true believers on climate action, there are concerns about transitioning to renewables too fast. For example, in California — a state that placed a big bet on solar power, wind power and battery storage — Governor Gavin Newsom recently proposed the development of a 5,000-megawatt (MW) "strategic electricity reliability reserve" of gas-fired plants and other mostly conventional sources that utilities could tap if renewables fall short during periods of high demand.

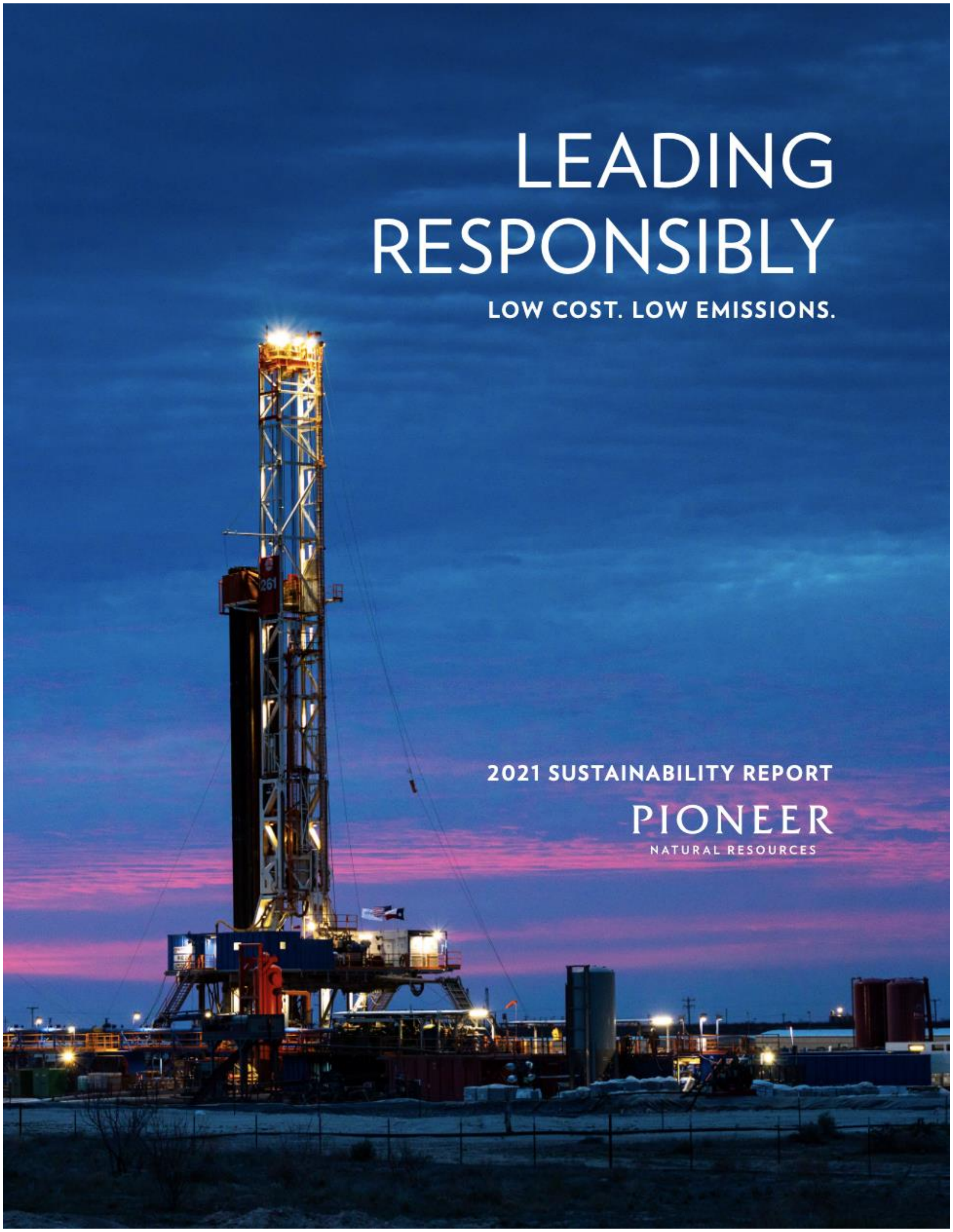
Put simply, the issues surrounding ESG and the energy transition are complicated — and becoming more so by the day. It remains clear that the transition toward a lower-carbon economy will continue, but the pace of that shift is still a work in progress and no one can say for sure yet what energy companies will need to do — or want to do — as the transition unfolds.

In this Drill Down Report, our aim is not to praise or condemn the ESG movement, but to acknowledge that it is likely to remain an important part of the energy industry landscape for years to come; to explain what ESG is about; and to discuss the forces that are likely to shape oilfield service companies, E&Ps, midstreamers and refiners ESG strategies in the 2020s and beyond.

Before we begin, we should note that while there are rumblings that climate-related initiatives may need to be reined in somewhat — at least in the short term — to address energy-security concerns, there's little evidence so far that energy companies at the forefront of ESG and climate action are pulling in their horns. Consider Pioneer Natural Resources, one of the largest oil and gas producers in the Permian Basin.

When Pioneer announced its $7.6 billion acquisition of Parsley Energy in October 2020 and discussed the strategic and financial benefits of the deal, it highlighted the two companies' "best-in-class" ESG practices, including a combined natural gas flaring intensity that is one-third that of its peers and aggressive efforts to reduce the use of freshwater in their Permian drilling-and-completion programs. Two months later, Pioneer released one of the most comprehensive sustainability reports ever assembled by an oil and gas company: 61 pages of text, photos, and graphs that discussed almost every imaginable environmental-, social-, and governance-related issue.

Pioneer's message to investors, lenders and the broader public couldn't have been clearer. It was telling the world that not only is it aware of the importance of climate change, workplace diversity, and a host of other ESG matters, it was acting to address them and making plans to do more. This included commitments to reduce the intensity of its operations' GHG emissions by 25% by 2030 and the intensity of its methane emissions by 40% within the same timeframe; eliminate all routine gas flaring by 2030 at the latest, with an aspiration to reach that goal by 2025; cut its reliance on freshwater and instead use more treated effluent water; and increase the company's executive incentive compensation weighting for ESG and health, safety and environment (HSE).



Pioneer Natural Resources' 2021 Sustainability Report

Fast-forward to September 2021, when Pioneer released an updated and expanded sustainability report (see cover above) in which the E&P established a new goal of net-zero Scope 1 and Scope 2 emissions by 2050; upped its 2030 commitments for reducing emission intensity to 50% for GHGs and 75% for methane (from the "old" 25% and 40% goals, respectively); set a goal to reduce freshwater use in well completions to less than 25% by 2026; and promised to implement a Task Force on Climate-related Financial Disclosure (TCFD) principles by the end of 2022. (More on TCFD principles later in this report.) Pioneer also touted the diversity of its executive leadership team — 47% female or ethnically diverse — and said it was aiming to increase that diversity over time.

Pioneer's message was unambiguous: It is all-in on ESG, and views it as a core element of the company's strategy going forward, along with its highly touted financial discipline. And Pioneer is far from alone. In fact, just about all of its peers in the U.S. and Canada are onboard with ESG as well. Other E&Ps are promising to slash the GHG intensity of their operations and offering "responsibly sourced" natural gas; midstream companies are committing to trimming methane emissions from their pipelines and buying more power from renewable sources; and refiners are touting their expansions into renewable diesel. And a growing number of energy companies are investing in clean hydrogen production, carbon capture and sequestration projects, and other climate-related ventures.

Say what you will about ESG — and some things that have been said aren't printable here — but it would be hard to argue against energy companies taking the time to examine where they stand on environmental, social and governance issues, and whether it might be worth their while to at least consider operational and managerial measures that would keep them within the mainstream of their peers. After all, improved environmental performance and efficiency, an inclusive and satisfied workforce, and better corporate practices and processes all can help a company prepare for upcoming regulations, attract the best staff, and make it even more attractive to investors.

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