ESG in the oil and gas sector: A very public issue

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As scrutiny of oil and gas companies' approach to environmental, social and corporate governance intensifies, Fieldfisher's Head of Oil and Gas Paul Stockley considers how the industry can satisfy the demands of stakeholders and spectators.

For oil and gas companies, environmental, social and corporate governance (ESG) has become synonymous with the wider issue of energy transition.

Even though hydrocarbons are currently still essential inputs for many industries, pressure is mounting to reduce the environmental (and in many cases social) impact of their extraction.

This pressure is not evenly applied, however, with oil and gas companies listed on stock exchanges seemingly coming under the most intense scrutiny.

Because public companies are more visible, they are in many ways easier targets for ESG critics than privately held oil and gas companies.

Public companies face greater reputational and financial risks than private companies from not maintaining high ESG standards, as share prices can respond quickly to criticism of a company's practices.

The ruling in May 2021 by the Hague District Court that Royal Dutch Shell is obliged to reduce the CO2 emissions of its group activities by 45% by the end of 2030, relative to 2019, also highlights the ESG litigation risk faced by big public companies.

That is not to suggest private companies are weak on ESG. In a highly regulated industry, oil and gas companies, however they are owned, are held to strict environmental, health and safety and anti-bribery and corruption legislation in the vast majority of jurisdictions where they operate.

In most cases, oil and gas companies also need a social licence to operate – i.e., the goodwill of local communities, which usually means implementing initiatives to benefit people that live near the project.

ESG is also increasingly relevant to private companies in terms of access to finance, with growing amounts of capital being ring-fenced for sustainable and "green" investments.

This includes oil and gas operations, where companies can make convincing arguments for environmental and social improvements as part of their projects (albeit that such funding is available pretty much exclusively for adapting existing projects, rather than commencing new developments).

Measuring ESG

Determining ESG performance relies on measurement and reporting.

Because private companies are not obliged to report financial results, produce annual reports or answer questions in publicly advertised shareholder meetings, their performance is more difficult to measure than that of their public peers.

This means that even when private companies do report on ESG activities, the public is less likely to hear about it.

There is currently no standard template for a "good" ESG programme for oil and gas companies.

While standardisation would be helpful in measuring and comparing different companies – public and private, large and small – in reality, every ESG programme will need to be project-specific.

Where companies can show evidence of community consultations, this is a promising sign that the company's ESG programme takes account of what the local issues are and how it can respond to these through its ESG activities.

Local need, including the needs of the local ecosystem as well as resident communities, rather than external stakeholder pressure, should be decisive on how the programme looks.

It is not always necessary to set firm goals that may be scuppered by unforeseen circumstances, but it is important to measure and report honestly on progress.

This can create problems if community priorities do not align with the ESG priorities of shareholders, or even the host country's government, and as such requires careful management and negotiation between numerous parties.

Common examples of disjointed policies include commitments to train local people to work on oil and gas rigs or in the hydrocarbons supply chain, at the behest of government, when it may be more useful to teach portable skills –

especially if the project may not make it into production or risks being shut down.

This is not always the case, however oil and gas companies should be mindful of how they can best serve their host communities and nations when investing in ESG activities.

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Use it or lose it

Governments of most countries that host oil and gas projects now require detailed environmental and social impact assessments (ESIAs) before they grant environmental permits, while others also call for environmental and social management plans (ESMPs), closure and rehabilitation plans and resettlement action plans (RAPs).

While these requirements are often highly prescriptive and take time to draw up and get approved, the emphasis of governments, NGOs and other stakeholders is shifting to the actual outcomes of ESG policies, rather than the length of plans and reports showing how companies intend to implement programmes.

There have been numerous examples of natural resources companies being stripped of exploration and operating licences for failing to progress projects (resulting in expensive investor-state litigation and arbitration proceedings), indicating that there are risks attached to taking a long time to develop plans and act on them.

The challenges of implementing ESG programmes

Putting corporate ESG philosophy into practice can be challenging, as things are always more complicated on the ground than they are on paper.

There are often significant upfront costs involved in implementing an ESG programme, although if they are the right initiatives they will pay off in the long term.

Cultural business norms in host countries can also be difficult to square with anti-bribery and anti-corruption legislation in an oil and gas company's home jurisdiction, but pleading local custom is not an excuse for or defence to breaking these laws.

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The sheer number of industry codes, principles and charters that companies can sign up to can also be overwhelming and it is important to select an initiative that best suits the company's particular business model.

Resource cycles can make it difficult to deliver on promises, but every effort needs to be made to maintain community relations, regardless of oil and gas price movements.

Management teams also need to ensure they generate and collect the right sort of data to inform their ESG reporting.

The benefits of ESG for oil and gas companies

By implementing a robust ESG programme, oil and gas companies both public and private can mitigate the risk of litigation from NGOs, other activist groups and national governments.

They can also reduce the risk of reputational damage – even if something does go wrong – by showing they are doing everything they reasonably can to be good corporate citizens.

Good ESG can also help companies attract the best talent and widen access to new types of shareholders and investors.

It is often said that the global oil and gas sector lacks a level playing field when it comes to ESG. This should be an impetus for wider adoption of better practices, rather than a motive for rejecting ESG.

Like many private operators, small and medium-sized independent oil and gas companies have largely escaped close scrutiny of their ESG policies (or lack of them), but this is changing fast.

Management plans need to be iterative and flexible enough to adapt to changes in ESG thinking and related legislation, or be prepared to draw the consequences.

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