Energy Intelligence

ENERGY COMPASS®

FRI, MAR 30, 2018

The Big Picture: Houston, You Have a Problem

• To a greater or lesser extent, oil firms are trying to address the challenges posed by climate change. And to a greater or lesser extent, they are failing. At the same time, the regulatory, investment and legal risks associated with climate change are proliferating -- in some cases in ways not even imagined a decade ago.

• How oil firms negotiate the changed environmental landscape could be the single biggest factor influencing corporate health over the next decade. If the industry fails to shed its reputation as a climate criminal, it faces all the downsides of a sunset industry -- legal challenges, divestment and recruitment difficulties -- even if hydrocarbons continue as the mainstay of the global energy system. Perception is all.

Despite, or perhaps because of its financial muscle, the oil industry has always struggled to win acceptance in the public imagination. While dirty coal got *Billy Elliot* (a touching story of an aspiring dancer in a ruined northern England coal town) and *Brassed Off* (the struggle of a coal pit band to keep its community together), oil got *There Will Be Blood* (in which black gold corrupts the dream of the American West) and 2011's *The Muppets* (in which an evil oil baron tries to destroy America's favorite furry friends), to mention just a couple of examples.

Climate change has sharpened this disconnect between the industry's projection of itself as the indispensable enabler of modern life and the society that it purports to service. The 2015 Paris climate agreement has proved to be a watershed moment. Events since then have largely not gone Big Oil's way, and threats are now mounting on multiple fronts.

In the last two years, pressure from financial institutions -- lenders, investors and insurers -- has replaced fear of government regulation as the main threat to the industry's core business. What were once fringe activist investor positions are now entirely mainstream, with majors forced to disclose vulnerability to stranded asset risk; roll out credible plans for emissions mitigation; and in some cases take a U-turn on environmentally damaging projects. Spearheaded by French financial institutions, getting funding and insurance for Arctic drilling and oil sands development is now getting more difficult (NE Oct.19'17).

At present, the emphasis is on disclosure of stranded asset risks, but there is a clear threat that investors will push for a greater say in capital allocation and project green-lighting, if they aren't already. Industry solutions such as carbon pricing and carbon capture and storage are perceived as both expensive and challenging, and seem to be losing traction as alternative technologies such as solar power and electric vehicles advance. The spread of affordable solar has undermined arguments that hydrocarbons are vital to end energy poverty in the developing world, while big advances in battery technology and renewables economics more broadly have given policymakers an alternative (EC Jun.30'17).

The industry had hoped for significant backing for gas as a bridging fuel as the world transitions to a low-carbon energy system. This policy has met with some success, as evidenced by EU financial backing of an LNG import project in Cyprus, Germany's approval this week of the Nord Stream 2 project to import more Russian gas, and World Bank support for Royal Dutch Shell's Iraqi gas investments -- but overall has not met industry expectations (WGI Nov.29'17).

The response so far from the industry's most high-profile climate scheme, the Oil and Gas Climate Initiative (OGCI) with its $1 billion war chest, has been underwhelming, with the dominant NGO reaction being that it is in line with the industry's long-standing attempts at "greenwashing." The OGCI brings together 10 oil firms, from state Saudi Aramco, Pemex, Petrobras and CNPC, to Shell, BP, Statoil, Eni and Repsol (but not their US peers).

Meanwhile, voices advocating wholesale rejection of hydrocarbons are have grown louder since Paris. Use of the Carnegie Endowment for International Peace's new Oil-Climate Index is illuminating. The index measures lifetime emissions of different crudes and should be a valuable guide for activists as to which types of production to target. Instead, the bulk of the index's usage has come from investors and energy companies, says Deborah Gordon, the index's architect. "I guess this reflects a fundamental belief among the environmental NGO community that we must get off oil altogether."

A confrontational zero-sum game industry-activist relationship is nothing new, but the problem is that these once-fringe views are now gaining wider traction. Plans by the New York City and state pension funds to divest from fossil fuel producers, with the city also suing five major oil companies over climate change-related costs, should be a wake-up call (EC Jan.26'18). Whether or not any prosecution is successful, such court cases mark a step change in the industry's risk landscape, notes Greg Muttitt, Research Director at NGO Oil Change International. "Whether or not they get found guilty, when you put oil companies in the dock, that changes perceptions, in the same way as what happened with tobacco companies," he argues.

First Steps

Changes, albeit not fast or fundamental enough for oil's critics, are happening. So far, US majors are focusing on managing their existing businesses better -- emphasizing short-cycle projects, energy efficiency and cutting their own emissions. European firms, headed by a triumvirate of Shell, Total and Statoil -- the latter of which this month announced plans to rebrand itself as Equinor, reflecting a move away from oil -- are touting a more adventurous approach.

Total and Statoil, which is targeting 15%-20% of its capital budget in renewables and low-carbon assets by 2030, are looking at becoming major renewables producers. Total exited coal in 2015 and is already a significant solar producer through its 2011 purchase of US firm SunPower and in 2016 acquired battery producer Saft. Shell recently pledged to cut lifetime emissions intensity from its products by 20% by 2035 and 50% by 2050. It is also committed to reducing emissions from its fuel sales through a new tree-planting scheme, with BP running a similar program.

But tree-planting efforts on their own will have only a limited impact, according to *Energy Compass* sister publication *EI New Energy*, and there's a lot more to be done (NE Mar.22'18). The industry might be right in arguing that challenges in transitioning to a low-carbon energy system are being dangerously underestimated, but it is equally clear that its position is a self-serving argument. To have any real credibility, the oil industry is going to have to push through real corporate change, but the challenges are formidable, and it does not have time -- or, seemingly, Hollywood -- on its side.

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