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Q&A-COVID-19 forced oil and gas firms to lower production, emissions; But investment activity shows it's just lip service: Andrew Grant, Carbon Tracker



COVID-19 forced some oil and gas companies to lower their production and emissions last year, but most firms have continued investing in projects that "look like they are stranded in a low carbon world," **Andrew Grant, head of oil, gas and mining at Carbon Tracker** told the Reuters Global Markets Forum on Wednesday, May 5.

"They may be talking about emissions a lot, but not all of their investment activity necessarily matches up," Grant said.

Grant said companies need to be more transparent in disclosing their asset retirement obligations as decommissioning of liabilities are funded from cash flows, and if the firm gets the timing of it wrong, the burden could easily fall on taxpayers.

It has "potentially big implications... regulators will need to protect the taxpayer, and have the companies put money aside now to cover these costs," Grant said.

Following are edited excerpts from the conversation:

Q: What is the status of carbon emissions reduction from the oil and gas and mining sectors?

A: Firstly - I think there are two important aspects to look at: 1) The environmental aspect, or what are companies doing to reduce their emissions; And 2) The financial risk aspect, or what are companies doing to mitigate their chances of destroying value with stranded assets.

The two things should ideally go together - it's no good cutting emissions if your portfolio gets wiped out as the world transitions. So, there are several different factors in play and the picture is evolving rapidly. Since Repsol announced a net zero ambition in December 2019, all of the European majors claim to have a net zero ambition in one way or another. But they are all framed differently, all cover different parts of their business -- e.g. BP's (British Petroleum) goal excludes its stake in Rosneft, which is about a third of its production, and are very difficult to compare.

Q: What has been the progress on transition targets by major companies?

A: It is hard to say because the targets are so recent, and mostly with longer term goals -- e.g. net zero in 2050, but increasingly they have nearer term 2030 goals too. Plus, on top of that, there has been the impact of COVID-19 -- some of the companies lowered their production/emissions last year, but not exactly by choice, but because the market conditions in oil were so tough. Our research has shown that most of the majors have continued to develop projects that look like they are stranded in a low carbon world - so again they may be talking about emissions a lot, but not all of their investment activity necessarily matches up.

Q: Do you see those risks abating, with the vaccine rollout, or not really, given the risk of the new variants from India, etc.?

A: Oil -- like many commodity markets -- has always been cyclical and volatile; there are always going to be periods of lower and higher prices. Risk management is a big part of it, and unpredictable things happen clearly. In the climate context, a lot of it comes down to scenario analysis - trying to pick conservative assumptions around future risks and position accordingly.

Q: How is the oil industry positioning for the growing share of renewables? Where does the biggest threat come from?

A: The challenge in recent years has been the industry shooting for growth, rather than seeking to generate returns based on conservative assumptions - the crash related to COVID-19 was the second in six years, and we'll see if that has a lasting impact.

It varies - most of the large ones are trying to develop low carbon businesses of their own. The balances of different technologies vary because the companies have different strategies around this and want to play to what they see as their strengths. However, the industry's history of investing in other sectors has been poor, to put it mildly.

Q: Do you think companies might have to increase their investments in green energy to meet the transition targets by 2030?

A: Some companies have set more aggressive targets than others. U.S. companies like Exxon and Chevron, have set targets that don't cover their end-use emissions. They are starting to dabble in low carbon businesses, but it's not a big part of their targets. Others in Europe that have set more ambitious targets will certainly be planning to accelerate their low carbon businesses.

Q: Do you see high commodity prices delaying the clean energy transition, as the International Energy Agency has stated?

A: Commodity prices are a double-edged sword. Renewables will have higher supply chain costs, but this will be at least partly be offset by the high learning rates and efficiencies from greater deployment at scale. Higher oil/gas/coal prices will mean that the cost competitiveness of fossil fuels will be impacted too. Both will drive higher efficiency, which is a huge part of reducing emissions.

Q: Do you think the Paris Agreement aims are almost impossible to achieve, given the need to cut fossil fuel production?

A: The Paris goals are a range, from "well below 2 degrees Celsius" to aiming for 1.5°C. Most think that 1.5°C is the most important target now, given the IPCC (Intergovernmental Panel on Climate Change) special report on 1.5°C -- which came out after the Paris Agreement, illustrated the harm even at these levels. Certainly achieving 1.5°C will be very tough and will need people to get acting quickly - but clearly things are accelerating quickly. I think 60%-70% of global GDP is now covered by a net zero target. But given the range, it's not really a binary outcome. It's not a case of if we can't get 1.5°C, we give up -- 1.6°C is better than 1.7°C. etc.!

Q: Do you see regulation being put in place to get companies to move toward some standard mid-century emissions goal?

A: There are a lot of different factors driving companies' emissions targets. Anticipating regulation is part of it - e.g. if a country/region sets a goal for net zero in 2050, as many have, then companies acting within those borders clearly need to incorporate that. Also, there is the financial system - increasingly investors/banks are looking for the companies they provide capital to be aligned with climate aims, for a variety of reasons. And of course, there is also the technology aspect - low carbon technologies are improving in cost terms very quickly, which can't be said for fossil fuels. Lower cost alternatives open up political space for policy action, so they all go hand in hand.

Q: How are companies accounting for potential climate-related policy changes, and how are they hedging their risks?

A: Trying to get financial statements reflecting these risks is an evolving and very interesting area. When testing their asset values for impairment, oil and gas companies have to make assumptions around future commodity prices. These are often much higher than you would expect under low carbon outcomes. For example, just last year Equinor was assuming a long-term oil price of \$82/barrel, although they have reduced it somewhat now. U.S. companies don't even disclose their commodity price assumptions, so very hard to understand the risk of impairment there.

On the liabilities side, asset retirement obligations are another area where there is little transparency but potentially big implications. If companies assume their future decommissioning liabilities will be far in the future and funded out of cash flows, what happens if the world moves away from fossil fuels, the assets are retired earlier, and the company has little cash flow? The burden could easily fall to the taxpayer. That happens already. This is an area where regulators will need to protect the taxpayer, and have the companies put money aside now to cover these costs.

Q: To what extent are companies' climate pledges dependent on carbon offsets? And do investors think carbon intensity targets are acceptable or should it all be about absolute carbon reduction targets?

A: The problem with intensity targets is twofold – 1) they allow continued growth in emissions if the company increases its volume but lowers the average intensity, which clearly doesn't get us to net zero; 2) By not incentivising against continued growth, they allow companies to keep trying to grow and hence the asset stranding risk is still there.

So again, problems on environmental and financial fronts. Carbon offsets are present in several of the companies' plans, put often with poor transparency. Shell are planning to remove 120 million tonnes of CO2 using nature-based solutions in the next 10-15 years - that's like planting a forest the size of a European country. But at least they've said what they're planning! Without that disclosure it's hard to understand the extent of the reliance on this. To be clear, we will need some sort of "negative emissions" to get to net zero - but it's constrained in scale, so that will be needed to cover off the last portions of emissions which are hard to abate, not enable continued business as usual.

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