The energy transition in oil and gas

June roundup

Hi everyone,

The big news this month is Shell increasing its targets for fossil fuel production this decade in an attempt to boost the company's valuation and shareholder returns. Off the back of record profits on its oil and gas business over the last year, the company has chosen 'cash over climate'. This appears to be rather short sighted - new fossil fuel projects could create a relatively small amount of extra cash in the short term for a lot of financial pain in the long term as these assets become stranded and demand for these fuels falls.

June has proven to be a tough month for the industry as regulators have taken aim at its greenwashing. Watchdogs have set the stage to cut off funding for new fossil fuel projects from net-zero aligned investors. The industry's lobbyists will now have to disclose their fossil fuel links when they attend the UN climate talks this year. None of these alone are body blows, but together they show the industry's strategy to maintain its legitimacy and public acceptance is at real risk of falling apart.

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Thanks,
Murray

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Stat of the month:

500,000 barrels a day

Additional oil and gas production required under Shell's new production targets

Oil and gas in the transition

Shell announced it will ditch its previous pledges to reduce oil and gas output and would instead maintain oil production at current levels and grow its gas business. In total, Shell's plan will require half a million barrels a day equivalent of new oil and gas by 2025 and its LNG business to increase by as much as 30% by 2030. To put that in context, Shell produced just under two million barrels a day equivalent of oil and gas in the first three months of this year.

Shell also distanced itself from some of its previous efforts to move into new sectors like renewables. Shell's CEO Wael Sawan recently scrapped several projects, including offshore wind, hydrogen and biofuels, due to weak financial return forecasts. He has also publicly stated that Shell has no competitive advantage that would justify a more aggressive move into renewables. Despite pledging to grow its core fossil fuel business and move away from some of its cleaner alternatives, Shell said that its strategy and emissions reductions targets remained unchanged (which may be fairly telling about how robust those targets were in the first place).

Alongside the renewed focus on oil and gas, Shell promised to increase investor returns, with shareholders promised 30%-40% of the company's cash flow, up from the current 20%-30%. This would bring it closer to the 39% average cash flow returned to shareholders across the industry last year.

Investors with a sharp focus on energy transition risks were quick to respond to Shell's announcement. Legal & General Investment Management (LGIM), the UK's largest asset manager and one of Shell's top ten largest shareholders, has called on Shell to explain how it now intends to meet its 2050 net-zero target.

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Its response should be a key test for the company, and for LGIM, which has pledged to divest from assets that pose an unacceptable risk to the environment. For the Church of England, Shell's announcement was already a step too far, with its pension and endowment fund both committing to offload their shares in Shell as part of a wider divestment across the oil and gas sector for its failure to take meaningful climate action. Some senior Shell staff also appeared unhappy with the company's strategic pivot, with its head of European renewable power and a senior renewable energy power trader both publicly quitting the company. The latter stated on LinkedIn: "I perceive that as pivotal (sic) shift in corporate values, and I feel that short term profits are above social and environmental responsibilities. I don't want to be part of that, so I'm out."

While Shell committing to pump more fossil fuels is pushing global emissions in the wrong direction, from a broader perspective oil companies doubling down on fossil fuels isn't necessarily all bad news for the energy transition. The industry was never investing that much money in clean energy, so it's not pulling a major funding source. In the last seven years, the oil majors invested just USD 113 billion in low-carbon technology, compared with a total energy transition investment of USD 4.8 trillion over the same period. Big oil moving out of clean energy also clears the way for the rest of the competition with a pure focus on renewables to make the most of this rapidly-growing sector.

Politically, the shift also clarifies the situation. In recent years, the industry has sought to position itself as a key part of the energy transition, committed to global climate goals and their own transformation. This image has protected them against more forceful action by governments and investors. Now, without substantial investments in renewables or plans to reduce oil and gas output, the oil and gas majors are very close to losing all pretence of Paris-alignment or transitioning to become clean energy companies. Together with the scrutiny the industry is facing over greenwashing and net zero targets (more on that below), it's possible we could arrive at a place where oil and gas companies are increasingly seen as just that - companies clearly dedicated to producing the fossil fuels that must be phased out to achieve the world's climate goals. For now, however, it's largely business as usual…

Corporate strategies

Net-zero targets are a mainstay of corporate action on climate, yet fossil fuel companies' targets are "largely meaningless" according to an analysis by Net Zero Tracker, run by the Energy and Climate Intelligence Unit and the University of Oxford. It found that, while 75 of the 112 largest fossil fuel companies have set net-zero targets, most don't comprehensively cover emissions from the oil, gas or coal sold, and don't have short-term emissions reductions plans. None "are making the necessary commitments to fully transition away from fossil fuel extraction or production," the analysis found. With increasing efforts led by the UN to set meaningful standards for net-zero targets, the industry is likely to come under further scrutiny for its failure to deliver the substance to back up its long term targets.

Alongside oil and gas companies' net-zero commitments, public advertising on their green credentials has been a central component of the industry's approach to maintaining public trust and support. This strategy, dubbed "lobby-tising", came under fire from the UK advertising regulator this month, as it banned adverts by Shell, Repsol and Petronas. This decision is a watershed, as the ads were banned on the basis that, while they promoted 'green' products or goals, they neglected to mention the overwhelming focus of their businesses on polluting activities. This takes a much broader view on what constitutes a misleading claim, and the extent to which companies need to disclose their overall impact. The companies were all warned to ensure future ads do not "misleadingly omit material information".

National oil companies

Ater months of focusing on the need to phase out "fossil fuel emissions" (rather than fossil fuels themselves), ADNOC CEO and incoming COP28 President Sultan Al Jaber finally acknowledged that "the phasedown of fossil fuels is inevitable". As a stinging FT editorial pointed out, while this shift from a pure focus on emissions is progress, without a timeline or plan to get agreement on a phasedown, the UAE risks "yet another wasted COP". UN Secretary General António Guterres didn't mince his words on the fossil fuel emissions framing put forward by the UAE Presidency, saying: "Let's face facts. The problem is not simply fossil fuel emissions. It's fossil fuels - period".

In a major step forwards for those working on conflicts of interest at the COP, lobbyists for fossil fuel companies will have to identify themselves as such for the first time at this year's UN summit. No doubt not all those with links to oil, gas and coal will be forthcoming in declaring all their ties, so lots of work still needs to be done by the fossil fuel lobbyist watchers in spotting those that don't.

Investors and finance

In a sign of the ever-growing pressure on the industry from investors, financial institutions that have set net-zero goals will have to stop financing new fossil fuel projects, according to draft guidance produced by the UN-backed Science Based Targets Initiative (SBTi). The SBTi, which reviews and verifies companies net-zero commitments, states that to have a credible net-zero target, they must "immediately stop any activities that support the development of new fossil fuel assets that enhance the stock of carbon emitting sources and create carbon lock-in." If implemented, this could end the current situation, where much of the finance sector has set net-zero goals but has collectively provided $5.5 trillion to the fossil fuel industry since the Paris agreement. These draft guidelines still have to survive the consultation process, which is likely to see significant pushback from parts of the industry. If agreed, the guidelines would come into force next year.

Separately, the costs of fossil fuel stranded assets would not have a significant impact on the investments of the majority of the population of Western countries, counter to the argument that phasing out fossil fuels would have a major impact on widely-held pension funds. This was the finding of a recent academic paper, showing that in a 2oC transition, the wealthiest 10% would bear two-thirds of the losses, while the bottom 50% would face less than 5% of the losses.

Investments and deals

Major oil and gas deals this month continued the trend of companies focusing their portfolios on gas and lower-emissions-intensity production. TotalEnergies increased its investments in LNG, taking a stake in the proposed Rio Grande LNG terminal on the US Gulf Coast, agreeing to purchase LNG from the terminal for 20 years and acquiring a sizable stake in the project's developer, Next Decade.

Meanwhile, Eni completed the largest cash deal in the European oil and gas sector for a decade, buying up rival producer Neptune Energy. The deal fits with Eni's forecast of growing global demand for gas and its target to increase the share of gas in its production, with gas making up three quarters of Neptune's production.

In order to help gauge how oil and gas companies are positioning themselves in the energy transition, this newsletter specifically focuses on how they are moving into renewables and clean energy. To offer up-to-date analysis, it uses insight from media sources and subscription-based databases, like BloombergNEF.