Nutwood

Letter from America: Historic milestone – big oil concedes on carbon

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In case you have not already noticed, the new occupant of the Oval Office could not be more different than the former. The most dramatic – and welcomed – difference since 21 Jan 2021 has been the absence of the barrage of the incessant tweets, press briefings, hyperbole and alternative facts emanating from the White House. It is boring and far less eventful. What a relief. Few people are complaining. This, however, is not to say that nothing is going on in the White House. On the contrary, Joe Biden has been rather busy changing the direction of the American domestic and international policies especially on energy and the environment.

On 22 March, two months into his term, major oil company executives were invited to a meeting with top White House officials to discuss, among other things, how to go about putting a price on carbon to address climate change, a 180-degree turn from his predecessor. Just the mere fact that such a meeting on such a topic took place was noteworthy.

Gina McCarthy, a former head of the Environmental Protection Agency (EPA) and currently the White House national climate adviser, hosted the virtual meeting which was attended by the CEOs of the fossil fuel industry's biggest players including Darren Woods of ExxonMobil, Mike Wirth of Chevron and Gretchen Watkins, president of Shell US. Also attending were Mike Sommers, the head of their powerful lobbying arm, the American Petroleum Institute (API), and the head of the American Gas Institute (AGI).

McCarthy told the executives what they already knew – that the Biden administration is determined to address climate change.

While the CEOs did not make any immediate announcements, Sommers offered the proverbial olive branch by stating that the API was "committed to working with the White House to develop effective government policies that help meet the ambitions of the Paris Agreement and support a cleaner future." How fast official positions change (Box).

Sommers, however, was quick to add, "Fossil fuels will be key to that future."

"Over the long term, the world is going to demand more energy, and independent forecasts show that natural gas and oil will provide approximately half of the global energy mix for decades to come. At the same time, we must tackle the challenge of climate change, and that's where our industry continues to lead by investing in low-carbon solutions."

The API and similar fossil fuel lobbying organizations around the world are under intense pressure from within

The energy world turning green?

Historically, not much would change from one year to another in the world of energy. Now, however, things are changing so rapidly and dramatically that it is a challenge to keep up to date.

In late March 2021, Bloomberg released a quarterly report of earnings calls and other media releases by the 23 members of the S&P 500 Energy Index. It showed that the mention of sustainability-related terms including environment, social and governance or ESG soared from 36 in the first quarter of 2020 to 300 in the first quarter of 2021. The energy sector, like all sectors, is changing its messaging.

Moreover, Bloomberg says it's not "all talk and no action". In February 2021, ExxonMobil said it was investing $3bn on carbon capture and storage (CCS) technology and added that it is working on more than 20 new CCS opportunities around the world to enable large-scale emission reductions. In Jan 2021, Marathon Oil, an independent petroleum and natural gas exploration and production company, said it achieved a 20% reduction in its carbon emissions intensity since 2019 while Occidental Petroleum Corp. announced that it was aiming to reach net zero emissions goal, the first US oil company to do so.

and without – since some members no longer want to continue fighting an unwinnable war on climate change. The scientific verdict is already out and is getting stronger while the public and investor pressure is mounting. The first sign of the disarray came last year when the French oil major Total announced that it was leaving the API because of disagreement on its position on climate change and carbon emissions. While the other oil majors have not followed, many have net zero carbon goals by 2050.

The debate within the fossil fuel sector is no longer about denying the role of carbon (or methane) emissions in climate change – as they did for decades – but how to navigate the inevitable energy transition to low carbon fuels and how soon.

According to those attending the WH meeting, the general consensus was to concede that the energy transition should follow a trajectory that limits the global temperature rise to no more than 1.5°C by 2050. Still, not all are totally convinced that the Biden administration has the resolve – and the political capital – to deliver. Just as Trump did his best to reverse Obama's energy and environmental policies, a future conservative Republican can throw Biden's plans out the door.

For now, the fossil fuel industry is resigned to go along with the Biden's green agenda – or at least not to fight it – while each company is deciding what is the best course of action including how a potential carbon tax may affect their existing assets and future investments. Since they are not equally endowed, they are likely to follow different paths.

What can an oil major do?

After enjoying many decades of steady growth and sustained profits, the oil majors – in fact all fossil fuel companies – are facing unprecedented pressure as their main products cause carbon emissions, which in turn are linked to climate change. They are no longer denying the basic facts. But what are they to do moving forward? Your editor asked Pedro Haas, Director of Advisory Services at Hartree Consulting, a hydrocarbon commodity trading and consulting business. He says oil and gas majors need to make a few big decisions that will determine their fate.

One option is to essentially leave the oil industry as did Dong, which become Ørsted, mostly focused on wind. The Spanish Repsol is also moving in this direction, although in a more diversified way. But the challenge for bigger companies is more complex. Some, such as Total, may create a bridge to renewable electricity. Others, like Chevron and ExxonMobil, seem committed to the hydrocarbon business – at least for the time being – not because they don't believe in the transition, but because they don't yet want to bet the farm on a specific course of action. They prefer a wait and see option.

Some companies like Valero and Marathon are primarily in the oil refining business and may believe that their business is in liquid fuels and not necessarily hydrocarbons. For them, hydrogen, biofuels and hydrocarbons might be a viable mix for the next 20 years. These companies do not invest in exploration and production but are engaged in refining, distribution and retailing. If hydrocarbons are taxed and/or banned, they can switch to biofuels or hydrogen.

As Haas notes: "But ultimately the problem for all of them is how to deal with the Scope III emissions associated with hydrocarbons. How do they manage that enormous mass of emissions at a time when offsets and other mitigation strategies are not available?"

"The only way out is by a drastic reduction of volume, which defeats the purpose of remaining in the hydrocarbon business. You have to conclude that the future liquid hydrocarbon market will shrink and that the carbon cost will essentially become an increasingly expensive tax that will impact the upstream and downstream profit margins. If you accept this scenario, you must conclude that only the national oil companies with the cheapest unit costs, such as the Saudi Aramco, will survive."

Haas adds: "The next big question is the trajectory: It won't be linear, as we are already experiencing, which means that the path will be littered with companies that will either head into bankruptcy or will be absorbed by survivors. Managing the financial health of these companies will be key. It will be messy, for sure. And fascinating to watch."

The signs of both the absolute and the relative decline of oil are hard to miss. As early as 2013, ExxonMobil at $500bn was the world's most valuable listed company. It has lost some $250bn in value from its zenith. Today, Apple is worth more than the combined market valuation of the 16 largest listed global oil companies. Tesla, a company devoted to disrupting the internal combustion engine business is worth $635bn. While big oil is trying to navigate its long-term future, the investors have decided where to park their money.