Leader, Fast Follower, or Left Behind?

Charting Your ESG Position

An Adamantine White Paper

by Jens Hybertson & Tisha Schuller

JANUARY 2022

ADAMANTINE
ENERGY

Introduction: **The ESG Whirlwind**

The landscape of ESG continues to mature, and the rise in expectations of companies is gaining momentum everywhere, including the oil and gas industry. Companies in the industry are increasingly setting new commitments, expanding the breadth and depth of their ESG reporting, and embarking on initiatives that signal game-changing leadership to the industry. This trend leaves many oil and gas leaders working to understand if their company is falling behind in ESG, where their efforts lie on the broader spectrum, and how to prioritize in the face of evolving expectations. And amid a whirlwind of announcements, frameworks, and initiatives, leaders are facing the conundrum of whether and how they should position their companies' ESG efforts as leading, fast following, or somewhere behind.

As the 2021 ESG reporting season came to a close, Adamantine examined a diverse set of oil and gas companies to gain a clearer picture of ESG positioning and leadership within the industry. Our team surveyed the ESG reporting materials of 38 publicly traded companies across the value chain, all with principal operations in the United States and with annual revenue ranging from $500 million to $100 billion. To gauge where the bar is being set and assess for leading indicators within specific ESG topics, we focused on prominent companies considered to be authentically engaged in proactive ESG strategies.

Adamantine's analysis does not mention companies by name or refer to specific numbers; readers seeking a comparative analysis of their peer group are encouraged to reach out for a customized engagement.

This report summarizes our findings and analysis. Our aim: to provide oil and gas leaders with insights and recommendations for meeting the evolving expectations around ESG and honing their ESG propositions into 2022.

Overview

This report breaks down our research findings on the ESG state of play in the oil and gas industry into five key topics: greenhouse gas (GHG) emission reduction commitments, environmental disclosures and initiatives, social topics, governance topics, and trends within ESG reporting and disclosure methods. Findings are categorized to assess for: where the bar is being set among specific ESG topics; leading indicators that could raise this bar to a higher level; and, where applicable, pioneering indicators.

Following the findings is a summary of Adamantine's key recommendations for company leaders. Recommendations are informed by the top-line trends companies should be focused on to ensure that their ESG strategies and reporting are in line with the industry. Finally, we outline strategies or initiatives to avoid for effective ESG action.

Our aim: to provide oil and gas leaders with insights and recommendations for meeting the evolving expectations around ESG and honing their ESG propositions into 2022.

Findings—The State of Play in ESG

Research findings are broken out into five categories:

GHG Emission Reduction Commitments

Environmental Topics

Social Topics

Governance Topics

ESG Reporting

Each research category is organized to convey:

a) where the sector bar is currently set;

b) leading indicators of ways companies are establishing themselves at the front of the pack, and

c) pioneering indicators of next-level leadership.

In our assessment, **the bar** in each of these categories represents the new minimum stakeholder expectation for companies in the sector. Companies not yet meeting the bar are now falling behind stakeholder expectations, allowing for some exceptions depending on company size, structure, peer group, and operating locations. Those looking to position their companies as "fast followers" should pay close attention to these areas in their consideration of where to focus company efforts. **Leading indicators** are those we expect to inform the bar within one to three years. **Pioneering indicators** go even further beyond the status quo and are worth watching to see whether they change expectations for peer companies.

GHG Emission Reduction Commitments

Emission reduction commitments refers to specific goals articulated by companies to the public. In the context of this section's analysis, commitments are focused on the reduction of GHG emissions. Because the nature of commitments varies dependent on a company's position in the value chain, this section has been broken out to analyze upstream, midstream, and downstream segments individually. (The downstream segment includes a combination of refiners, chemicals companies, and gas and electric utilities.)

Upstream	
The Bar	**Interim Emission Reduction Commitments:** Most of the upstream companies we reviewed have established interim (pre-2050) emission reduction commitments, predominantly focused on reducing emissions intensity, methane emissions, and flaring. Even those without interim emissions commitments have near-term (pre-2025) emission reduction commitments. Only one company assessed did not have any external emission reduction commitments established.
Leading Indicator	**Committing to Net-Zero:** Leading upstream companies have committed to achieving net-zero Scope 1 and 2 emissions by 2050 at latest.
Pioneering Indicators	**Net-Zero Scope 3**: Pioneering upstream companies have included Scope 3 emissions within their net-zero targets. **Pre-2050 Net-Zero:** A small sample of upstream companies have committed to achieving net-zero Scope 1 and 2 emissions earlier than 2050, even as early as 2025.
Midstream	
The Bar	**Interim Emission Reduction Commitments:** Approximately one-half of analyzed midstream companies have established interim (pre-2050) emission reduction commitments, predominantly focused on Scope 1 and 2 GHG emissions, emissions intensity, and methane intensity. Even those companies without interim emission commitments have established near-term (pre-2025) emission reduction commitments.
Leading Indicator	**Committing to Net-Zero:** Leading midstream companies have committed to achieving net-zero Scope 1 and 2 emissions by 2050.
Downstream	
The Bar	**Interim Emission Reduction Commitments:** Most analyzed downstream companies have established interim (pre-2050) emission reduction commitments. These commitments predominantly focus on (a) reducing Scope 1 and 2 emissions, (b) reducing emissions intensity, and in some cases (c) increasing renewable fuels procurement or supply. Even those companies without interim emission commitments have established near-term (pre-2025) emission reduction commitments.

Downstream (cont'd)	
Leading Indicators	**Committing to Net-Zero:** Leading downstream companies have committed to achieving net-zero Scope 1 and 2 emissions by 2050 at latest.
	Net-Zero for Gas Businesses: Among utilities with both gas and electric business lines, leading companies have established separate net-zero emissions commitments specific to their gas businesses, covering Scope 1 and 2 emissions.
Pioneering Indicators	**Net-Zero Scope 3**: Downstream companies going a step further have included Scope 3 emissions within their net-zero commitments. This trend is particularly pronounced among utilities and chemicals companies.
	Pre-2050 Net-Zero: A small sample of downstream utility companies have committed to achieving net-zero Scope 1, 2, and 3 natural-gas-related emissions by 2045.

Environmental Topics

Environmental topics refers to emissions disclosures, initiatives to monitor and reduce emissions, water recycling and reuse within operations, and initiatives to research and develop decarbonization technologies.

Because differences in environmental disclosures and relevant initiatives are more distinct between downstream companies and their up- and midstream counterparts, this section analyzes the up- and midstream segments combined and the downstream segment separately.

Upstream & Midstream	
The Bar	**Scope 1 and 2 Disclosure:** All analyzed up- and midstream companies are disclosing Scope 1 and 2 emissions in their reporting. Similarly, most companies are disclosing emissions intensity metrics, with denominators varying among companies.
	Reducing Methane: Most analyzed up- and midstream companies are participating in external initiatives focused on reducing methane emissions. Relevant initiatives include membership in Our Nation's Energy Future (ONE Future), the American Petroleum Institute's Environmental Partnership, and other industry and academic partnerships.
	Water Recycling: Within the upstream segment, all analyzed companies are reusing water within their operations.

Upstream & Midstream (cont'd)	
Leading Indicators	**Scope 3 Disclosure:** Leading up- and midstream companies are disclosing Scope 3 emissions in some capacity. This trend is more prevalent among upstream companies. Of note, Scope 3 disclosures vary by emissions category and degree of scope reported. As an example, one company may report Scope 3 emissions associated with the use of sold products (representing downstream Scope 3 emissions), and another company may report Scope 3 emissions associated with both upstream and midstream transportation and distribution, processing of sold products, and use of sold products. Other categories of Scope 3 emissions may include emissions associated with business air travel, employee commuting, and upstream or downstream leased assets.
	Emissions Monitoring: Leading companies are going beyond regulatory requirements by implementing aerial emissions monitoring, continuous air monitoring near residents, pilot projects for new detection and monitoring solutions, partnerships with stakeholders to improve emissions transparency across the value chain, and initiatives to have products certified as low-emissions through emission monitoring and verification partnerships.
	Strategies to Reduce Emissions: Of companies with emissions reduction commitments, leaders are disclosing detailed strategies for achieving these commitments. Such strategies generally involve a detailed breakdown of emissions sources, specific actions to reduce emissions among these sources, projected achievable reductions, and in some cases a breakdown of relevant costs and timelines.
	Exploring Decarbonization Technologies: Leading companies are engaged in internal or external research and development initiatives on decarbonization technologies. Key technologies being explored include carbon capture and sequestration, utilization, and storage (CCS/CCUS), renewable natural gas (RNG), and hydrogen. This trend is more commonplace among analyzed midstream than upstream companies.
	Commitments to Improve Water Use: Leading upstream companies are articulating commitments to reduce freshwater consumption or increase water reuse within operations.
Downstream	
The Bar	**Scope 1 and 2 Disclosure:** All analyzed downstream companies are disclosing Scope 1 and 2 emissions. Similarly, most analyzed companies are disclosing emissions intensity metrics, with denominators varying among companies.
	Exploring Decarbonization Technologies: Most analyzed downstream companies are engaged in internal and/or external research and development on decarbonization technologies (i.e., CCS/CCUS, RNG, and hydrogen).

Downstream (cont'd)	
Leading Indicators	**Scope 3 Disclosure:** Leading downstream companies are disclosing Scope 3 emissions in some capacity. Like up- and midstream disclosures, Scope 3 disclosures vary in terms of emissions category and degree of scope reported.
	Strategies to Reduce Emissions: Among companies with emission reduction commitments, leaders are disclosing detailed strategies for achieving their commitments. Such strategies generally focus on investing in and planning for new low-carbon technologies, projecting emission reductions associated with operational improvements, and exploring new lines of business.

Social Topics

Social topics refers to the disclosure of employee diversity data, initiatives to improve diversity and inclusion, community engagement efforts, and initiatives to strengthen workforce development. This section analyzes upstream, midstream, and downstream segments combined.

The Bar	**Diversity Disclosures:** Across the value chain, companies are disclosing gender diversity and non-White representation among employees. Most companies are also discussing practices or plans for improving employee diversity.
	Charitable Giving: All analyzed companies are engaged in structured charitable giving activities.
	Workforce Development: Most companies have professional development and tuition assistance programs in place for their employees, and most are disclosing average hours of employee training on an annual basis.
Leading Indicators	**Efforts to Improve Diversity:** Among companies with plans to improve diversity, leading companies have linked compensation (executive, management, and/or employee-level) to improving diversity metrics and outcomes. Leading companies are also engaged in efforts beyond their hiring practices to improve diversity. Relevant activities include: supporting diverse candidate training within the company; funding scholarships for underrepresented groups within operating communities; and partnering with organizations that promote educational and career opportunities for underrepresented gender, ethnic, and racial groups.
	Attention to Pay Equity: Leading companies have pay equity policies in place or provide relevant narratives for evaluating and strengthening pay equity within their organizations.
	Focus on Suppliers: Leading companies are considering factors other than cost during bidding processes for vendors, contractors, and suppliers. In general, these considerations involve the assessment of key ESG criteria when making purchasing decisions. Leading companies are also establishing commitments to improve supplier diversity, and some even outline targeted spending amounts with diverse suppliers.

Pioneering Indicators	**Commitments to Improve Diversity:** In addition to articulating efforts to improve diversity, pioneering companies are establishing external (sometimes metric-driven) commitments to improve racial, ethnic, and gender diversity within their organizations.
	Commitments to Advance Employee Engagement and Training: Companies going a step further are articulating specific commitments to achieve certain levels of employee engagement or employee training opportunities.

Governance Topics

Governance refers to the disclosure of lobbying and political spending activities, the alignment of political and regulatory advocacy with climate and ESG commitments and strategies, the role of the board in ESG oversight, and the independence of board members. This section presents upstream, midstream, and downstream segments combined.

The Bar	**Board-level ESG Oversight:** Across the value chain, all reviewed companies have some form of board-level oversight on ESG management. Although relevant oversight structures vary, most companies are placing ESG oversight either within a separate, dedicated board committee or within an existing board committee. Some companies have placed ESG oversight within the board's general responsibilities, and a small number of analyzed companies are utilizing each of these oversight functions in tandem.
	Lobbying and Political Spending Disclosures: Most assessed companies are disclosing lobbying and political spending activities. Levels of detail vary significantly among companies, though the bar is set at outlining trade memberships and annual political expenditures.
	Board Independence: Most analyzed companies are disclosing greater than 75 percent independence within their boards. Broadly, board independence refers to the ratio of non-management directors on the board with no material relationship to the company to the total number of board members.
Leading Indicators	**Alignment of Lobbying and Political Spending with ESG Strategies:** In addition to their general disclosure of trade memberships and political expenditures, leading companies are disclosing a higher level of detail on the decision-making process behind their lobbying and political activities and how these activities align with stated climate and ESG commitments. Leading companies are also disclosing more details on the ways lobbying and political spending activities are governed within their organizations, often citing relevant policies in place.
	Integrated ESG Oversight: Leading companies are going further than the general discussion of board-level ESG oversight by discussing the ways ESG topics and risks are governed, through the company's chain of command up to the board level. Leading ESG governance structures generally involve a dedicated board-level committee having final oversight on ESG matters, an executive-level committee reporting up to this board-level committee, and a managerial or field-level workgroup reporting to and supporting the executive-level committee on key ESG matters.

Leading Indicators (cont'd)	**Separate Chair and CEO Positions:** As discussed in Adamantine's 2021 proxy season report, a noteworthy topic on shareholders' minds in 2021 was the separation of the chair and CEO positions. Most leading companies have separate positions for their CEOs and chairs.

ESG Reporting

ESG reporting refers to the mechanisms and frameworks by which key ESG topics are disclosed, the use of historical comparisons when disclosing numerical metrics, and the incorporation of climate-related risk and scenario analyses within reporting materials. This section analyzes upstream, midstream, and downstream segments combined.

The Bar	**Materiality Assessments:** Across the value chain, all analyzed companies are using materiality assessments to inform their reporting topics. Materiality assessments broadly encompass formal consultations with a variety of stakeholders to understand which specific ESG topics are of most importance to them and thus where the company will center its priorities.
	Historical Data Comparisons: All analyzed companies are disclosing year-over-year comparisons for the majority of numerical metrics reported.
	Reporting Frameworks: Most analyzed companies are reporting in line with the frameworks issued by the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD). Additional reporting frameworks referenced commonly include the Global Reporting Initiative framework, the IPIECA sustainability reporting guidance for the oil and gas industry, and the United Nations Sustainable Development Goals.
	Climate Scenario Analyses: Most reviewed companies have performed and are disclosing the details behind a climate scenario analysis, which principally examines the ways existing and future climate action may affect the demand for hydrocarbons and thus the companies' resilience in the evolving energy future.
Leading Indicators	**Sector-Specific Reporting Frameworks:** In addition to using common frameworks to inform reporting, leading companies are also utilizing sector-specific frameworks developed by trade associations to inform their reporting content and disclosures.
	Separate Climate Reporting: In addition to disclosing climate scenario analyses, leading companies are issuing separate reports specific to their climate strategies, which principally address their businesses' climate-related risks, opportunities, and initiatives. This trend is most prominent among analyzed upstream and downstream companies.

Recommendations: **What to Work on Now**

Adamantine's recommendations are informed by where the bar is currently set on key ESG topics and which leading indicators are of importance for companies to consider in their strategic planning.

To account for differences in ways readers may be seeking to position their companies' ESG efforts relative to the industry, recommendations are broken out into two sections. The first list outlines top priorities for companies seeking to become or remain fast followers. The second list outlines key considerations for those seeking to position their companies at the front of the pack.

Finally, Adamantine's analysis uncovered a clear list of what not to do.

Recommendations for Fast-Following Companies

The bar has been set. Here is a list of ways to keep your company from falling behind:

- **Commit to Reducing Emissions:** Companies that have not yet articulated any commitment toward reducing their carbon footprint are now falling behind and risk the perception that they may not be a viable part of the energy evolution. *First step:* Begin assessing what your trajectory could look like to arrive at net-zero operational emissions over time, what will be needed to enable this progress, and what can be publicly committed to.

- **Prepare for Scope 3:** Companies not yet disclosing Scope 3 emissions should prepare for this level of disclosure. *First step:* Begin with identifying relevant reporting frameworks, estimation guidelines, and data-tracking needs.

- **Articulate an Emissions Reduction Strategy:** All companies, even those with emissions reduction commitments in place, should work toward better articulating their actual emissions reduction strategies. *First steps:* Start by improving your company's understanding of its emissions and relevant emission inventories to derive an actionable and substantiable reduction strategy. Explore the associated costs and investment timelines for decreasing emissions and begin compiling this information for anticipated disclosure.

- **Expand the Decarbonization Toolbox:** Now is the time to demonstrate your company's positioning for a decarbonizing energy future. *First steps:* Explore both internal opportunities and external partnerships to expand your company's involvement in developing decarbonization solutions and consider what pilot projects or feasibility studies may best inform your company's forward-looking strategy.

- **Advance Efforts on Methane:** The pressure is on to improve the industry's understanding and quantification of methane emissions. *First steps:* Focus on improving accurate methane quantification and measurement within your operations to better understand and articulate your company's impacts. Expand this focus to other parts of the value chain and consider joining a relevant industry or academic partnership to advance your knowledge and credibility.

- **Improve Diversity and Inclusion Programs:** All companies are under pressure to improve the diversity of their workforces and the inclusivity of their operations. *First steps:* Examine your current workforce demographics in comparison with the demographics of your surrounding communities and identify what gaps need to be filled to strengthen diverse representation across your company. Establish metric-driven goals for improving diversity, home in on diverse candidate recruitment and training opportunities, and explore initiatives and partnerships that can help advance career development within underrepresented groups. Consider engaging external resources to help your company improve diversity and inclusion throughout your operations and culture.

- **Bring ESG to the Board:** Now is the time to integrate ESG oversight at the board level. *First step:* Focus on establishing senior-level accountability for ESG progress and integrating ESG factors into corporate decision-making processes.
- **Examine Lobbying and Advocacy within Climate and ESG:** If your stakeholders start placing pressure on your company to disclose more information about your lobbying and political activities, it is critical to understand what story your data will tell. *First steps:* Assess your trade memberships, political expenditures, and key areas of policy support to determine if and how these activities are in alignment with your ESG commitments and climate positioning. Explore opportunities to strengthen this alignment and consider where changes may be warranted.
- **Expand Climate-Related Reporting:** Investors are increasingly putting pressure on companies to analyze and disclose how the impacts of climate change and relevant climate action could affect their business. *First steps:* Begin discussing this analysis internally and start collecting the information you will need to inform a climate-specific report in the near future. We recommend reviewing and considering answers to the CDP Climate Change Questionnaire, a leading framework on climate-related risk, strategy, and governance reporting.

Considerations for Game-Changing Leaders

Our analysis revealed a number of leading indicators on key ESG topics. Here is a short list of ways to put your company ahead of the pack:

- **Improve Emissions Transparency.** This move includes cross-value-chain partnerships to advance understanding of life-cycle emissions, with the goal of providing detailed emissions quantification to your customers and stakeholders.
- **Commit to Gas-Related Emission Reductions (Utilities).** For utilities with both gas and electricity business lines, articulate a separate emission reduction commitment for your gas-related operations.
- **Link Compensation to Diversity.** Establish specific, metric-driven commitments for improving diversity and link progress to compensation.
- **Improve Your Diverse Talent Pipeline.** Establish initiatives to improve your company's diverse talent pipeline and incorporate specific actions and internal accountability for progress. Relevant examples may include partnerships with trade schools, support for organizations focused on diverse talent development, scholarship support for diverse candidates, and adjustments to recruiting efforts and hiring practices.
- **Conduct Detailed Climate Scenario Analysis.** Within climate scenario analyses, incorporate factors beyond those outlined in the International Energy Agency's World Energy Outlook to account for a broader array of climate-related scenarios and better articulate your company's unique risks and opportunities.
- **Convey Your Unique ESG Strategy.** Within your reporting, provide detailed discussion describing the unique factors that inform your company's ESG strategy, why certain ESG topics are of greater or lesser significance to your company, and how key ESG topics are deemed material.
- **Incorporate ESG into Your Financial Strategy.** Link ESG metrics, targets, and progress to

financial strategies through the issuance of sustainability-linked financing vehicles or sustainable financing frameworks.

What Not To Do

Adamantine learned some clear lessons in the course of our analysis, noting ESG activities and reporting that fell short of stakeholder expectations. Be sure that your company does not commit any of the following errors:

- **Scattered Reporting.** Do not make your reporting hard to find. Some companies have distributed their ESG reporting across multiple webpages and documents; this scattered reporting was likely not intentional, but it makes relevant information difficult to review. Create and maintain a central repository for all ESG content and make key information easily accessible to stakeholders.
- **Unclear Commitments.** Do not establish emissions commitments without the supportive detail, investments, and formal initiatives that will enable these commitments to be realized. Similarly, do not establish commitments to improve your company's diversity without articulating the plans and initiatives already underway.
- **Incomplete Data.** Do not disclose your key performance through metrics that don't tell the full story. Incomplete disclosures include reporting emissions intensities that don't give a holistic view into the actual emissions profile of a company, such as utilizing only a denominator focused on earnings metrics.

Taking Your ESG Strategy to the Next Level

After examining where the bar has been set for the oil and gas industry, readers should have valuable insights into where their companies' current efforts lie on the ESG spectrum and what leadership looks like within specific ESG topics.

In addition to understanding the major trends across the industry, game-changing leaders also seek to understand exactly where their companies sit relative to their own peer group. Such precise siting allows their companies' ESG strategy to be benchmarked against peer progress, guided by an understanding of their key priorities and issues, and strategically oriented around whether their companies seek to position themselves as leaders, fast followers, or somewhere behind.

Interested in understanding exactly where your company is relative to its peers? Adamantine conducts in-depth assessments as part of our Opportunities and Risk Analysis services. Reach out today to explore how your company can right-size its ESG strategy.

Jens Hybertson *is the Research & Engagement Coordinator at Adamantine where he supports the firm's trend monitoring and analysis activities, strategy development, and project execution.*

Tisha Schuller *is the CEO and Founding Principal at Adamantine Energy where she leads Adamantine's work helping oil and gas companies future-proof their businesses against rising social risk.*

ADAMANTINE ENERGY
info@energythinks.com
720-663-1028