ARTICLE

ESG Strategy Development and Reporting in the Oil & Gas Industry:

Enhancing Competitive Advantage and Reducing Liability through Best Practice Reporting Grounded in Materiality, Data, and Transparency

Oil and gas companies have good reason to pay attention to the importance of carefully implementing ESG programs and their associated goals, claims and disclosures. While it is now generally expected that most companies pursue such initiatives, the ESG Reporting ecosystem in the United States currently lacks effective, universal non-voluntary standards to guide consistent disclosures of potentially material information. Therefore, ESG strategy developmentand implementation, and the related communications can be a risky double-edged sword.

Companies are expected to communicate their initiatives, goals, and potentially material risks and opportunities – but doing so without formal guardrails often exposes them to multi-stakeholder criticisms for (a) not meeting stakeholder demands for more robust transparency on ESG issues, or (b) providing information purported to be decision-useful, but with closer scrutiny from stakeholders arguably lacks the substance to support ESG representations. Expectations and scrutiny are undoubtedly only going to grow as additional spotlights get placed on ESG issues, such as those issues surfaced the United Nations' Intergovernmental Panel on Climate Change (IPCC) report that was issued on August 9th. Despite the UN Chief characterizing the global current state as a "code red for humanity," reasonable hopes do exist that deep emissions cuts in greenhouse gases could stabilize rising temperatures and avoid a catastrophe.[1]

Case in point, in 2021, there have been some significant developments in the oil and gas industry in the form of noteworthy claims that companies either are not doing enough or that they are overstating their ESG accomplishments.[2] At best, these claims can harm

1 https://www.dol.gov/sites/dolgov/files/OPA/newsreleases/ui-claims/20201406.pdf

2 June 22, 2021, Reuters, Fossil fuel firms face new challenge over 'greenwashing' ads, David Sherfinski (https://www.reuters.com/article/usa-fossilfuel-climate-change-advertisin-idINL5N2O347N); May 5, 2021, EHS Daily Advisor, Greenwashing: Lawsuit Charges Oil Companies with False Advertising (https://ehsdailyadvisor.blr.com/2021/05/greenwashing-lawsuit-charges-oil-companies-with-false-advertising/)

corporate reputation, reducing the credibility of management and bringing into question the legitimacy and transparency of more traditional and unrelated strategic initiatives. At worst, these claims could result in legal liability, overhauls to existing corporate governance structures, increases in the perceived and real cost of capital, and/or negative impacts from customers' unwillingness to continue with business as usual.

To make matters more complicated, the multitude of standards and frameworks emerging to facilitate disclosure of such information vary in rigor, focus and perceived legitimacy. Not only does this dysfunction create a seemingly unending maze of questionnaires, standards, frameworks, and third-party bodies assigning ratings based on different factors, but it empowers critics to claim that companies are exploiting the lack of standardization by choosing to disclose under mediums that provide more favorable interpretations of disclosures and data.[3] While the authors of this newsletter are by no means defending "bad actors," we would argue that even companies with the best intentions may be set up for failure. When 'failure' comes in the form of customer dissatisfaction, increased liabilities, higher costs of capital, and wavering reputation, companies must not treat these looming threats as ones that will dissipate, but as opportunities to embrace transparency, drive operational change, and proactively set the record straight.

On the topic of climate change-related litigation alone, more than 1,600 lawsuits have been filed against companies and governments to date, and the lawsuit count has grown more than 15% annually during the last two years. Legal battles aside, with the publicity surrounding notable ESG-related shareholder activism campaigns, we expect investors to continue backchanneling with executive teams to share "constructivist views" – those provided in private – and to launch hostile activist campaigns if their perspectives fall on deaf ears or on those unwilling to act quickly enough.[4] As we have seen recently, shareholder activist campaigns[5] can be swift and immensely forceful, oftentimes resulting in meaningful shakeups to the executive team and board of directors.[6]

This newsletter intends to aid companies in successfully navigating the complex and unprecedented demands of stakeholders in a way that is intellectually honest and fully transparent by providing (a) insight into a select set of red flags that may lead stakeholders scrutinizing ESG efforts to reach potentially inaccurate and unfavorable conclusions; and (b) point-for-point actions a company should consider to ensure its approach to ESG strategy development and reporting is grounded in data and materiality, and that related efforts ultimately create value for the company as well as its stakeholders.

3 https://www.wsj.com/articles/companies-could-face-pressure-to-disclose-more-esg-data-11607263201

4 June 1, 2021, Jefferies, ESG & Business Leadership: A C-Suite Roadmap

5 May 26, 2021, WSJ, Oil Giants Are Dealt Major Defeats on Climate Change as Pressures Intensify

6 See Carolyn Davis, ExxonMobil, Chevron and Shell Events Said to Underscore Value of ESG Initiatives, Natural Gas Intelligence, May 29, 2021 (naturalgasintel.com/exxonmobil-chevron-and-shell-events-said-to-underscore-value-of-esg-initiatives/)

Select Red Flags and Corresponding Recommendations

RED FLAGS THAT ARE AVOIDABLE	RECOMMENDATIONS TO REDUCE RISK AND DRIVE MULTISTAKEHOLDER VALUE CREATION
Treating 'ESG strategy development & communications' as a compliance, "check-the-box" excercise	**You should:** — Ensure all data, disclosures, and policy descriptions provided tie to issues that are material and/or ones that have been deemed a priority by management or key stakeholders (or ideally both). — Compete a materiality assessment – the cornerstone of an effective and sophisticated ESG strategy – to ensure all disclosures, data and related goals and/or targets tie clearly to materiality are aligned with business objectives and meet the expectations of key stakeholders. Doing so thoughtfully can eliminate the chance that a company is perceived as one that addresses sustainability reporting as a "check the box" exercise. **You should NOT:** — Provide a laundry list of data without clear rationales and context that would provide stakeholders with the ability to analyze the data, understand the factors that could affect data trends, and compare your company's sustainability performance vs. others. Doing so will signal to the market that the company has failed to understand key tenets of a meaningful sustainability strategy – the provision of decision-useful information that is rooted in materiality and followed by relevant improvement-oriented action.
Modifying recommended disclosures under well-established sustainability reporting standards and frameworks	**You should:** — Ensure that all modifications and omissions in response to suggested disclosures by sustainability reporting standards, such as those provided by the Sustainability Accounting Standards Board (SASB) are supported by sound rationales. Modifications, omissions, and estimations are both "accepted" and expected – particularly given that some information is competitively sensitive and standards are merely suggestive – but if appropriate related context is not provided, companies forgo plausible deniability that they are acting in the best interest of all stakeholders and with full transparency. **You should NOT:** — Modify definitions of certain metrics and scope to suit existing methods of capturing data or present only proof-points deemed favorable. Not only would this approach potentially call into question how much positioning and "spin" is present in disclosures and related data, but it may also reduce the ability of stakeholders to effectively evaluate a company's sustainability performance against industry or market peers, and ultimately result in an exercise void of value or utility.
Failing to develop, maintain, and/ or or disclose appropriate and effective oversight and governance mechanisms	**You should:** — Form an organizational structure that enables your company to progress meaningfully on existing or anticipated commitments, goals, targets, and/or topics deemed material. — Ensure individuals across the organization involved in oversight and governance of sustainability efforts have lines of sight into data, policies, initiatives, and innovation levers as they relate to topics deemed material — Align hiring and human capital development with skills needed to effectively deliver on anticipated or stated sustainability objectives. **You should NOT:** — Rely on legacy oversight and governance structures to effectively execute on new ESG imperatives. As with any strategic imperative, proper oversight and governance mechanisms – and the involvement of the board of directors in any capacity – is the appropriate course of action. Foregoing this critical component of a meaningful and actionable sustainability strategy will stifle progress, and signal to stakeholders that the company views sustainability as a positioning or "check the box" exercise instead of one integrated into its fundamental business strategy.

Where to Go from Here

There is no one-size-fits-all approach to ESG and attempting to address an ESG mandate with a "check-the-box" mindset will likely backfire, as stakeholders are increasingly well-versed in criticizing such efforts as not going far enough, or going too far and misrepresenting realistic goals and outcomes. Companies can accelerate and de-risk their sustainability journey by ensuring programs are genuine, grounded in data, aligned with the broader business strategy and the needs of key stakeholders, and fully integrated across the organization. ESG programs should be authentic, with clear objectives and an understanding of stakeholders' priorities at their core. Multiple frameworks, rating models, etc. are simply tools that companies can use – in whole or in part – to provide useful disclosures and showcase progress to stakeholders. Effective ESG program development should be rooted in research, highly strategic, reinforced by creative content development, and supported by a governance structure that integrates the program into business objectives and ensures key initiatives are successfully implemented across the organization. With careful and strategic implementation that meets expectations of stakeholders such as customers, investors and regulators, ESG programs can avoid significant reputational, legal and operational risks, but be value creative as well.

If you are actively considering any of the topics reflected in this writeup and could benefit from counsel in any capacity, please contact the authors of this writeup directly via phone or email or a broader group of experts at ESGAdvisory@fticonsulting.com.

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