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**OIL & GAS INDUSTRY TURNING TO
RESPONSIBLE INVESTING AS A MEANS TO
MINIMIZING ITS EFFECT ON CLIMATE CHANGE**

SPECIAL FEATURE:

**GREEN ENERGY REVOLUTION ON THE
ANVIL: SHAPING THE BIOMASS-BASED
BIO-ENERGY SECTOR IN INDIA**

INFOCUS:

**TESTIMONY OF AN EV OWNER AND
KEY LEARNINGS FOR THE SECTOR**

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IMPACT OF ESG INVESTING ON THE OIL AND GAS SECTOR

In the following article, **Mr. Dipankar Ghosh, Partner & Lead – Sustainability, Climate and ESG, Thinkthrough Consulting** and **Ms. Varsha Dandapani, Senior Consultant – Thinkthrough Consulting** discuss the rise of ESG investing across the globe and its impact on the Oil & Gas sector.



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RISE OF ESG INVESTING

ESG investing, or commonly referred to as responsible investing, is a strategy and practice to incorporate environmental, social, and governance (ESG) factors in investment decisions and active ownership. It covers a wide spectrum of issues such as climate change, resource depletion, human rights, employee relations, corporate governance and ethics, etc., which are traditionally not a part of financial analysis, but have an impact on financial performance. Typically, the approach to responsible investing is a combination of incorporating ESG issues into existing investment practices and engaging with investees to improve their ESG performance.

Over the last few years, we have witnessed ESG investing gaining traction across all geographies. The term ESG was coined in 2004 when the UN Secretary General Kofi Annan invited 50 CEOs of major financial institutions to participate in a joint initiative of UN Global Compact, International Finance Corporation, and the Swiss Government with the objective of integrating ESG issues into capital markets. Some of the recent milestones in its evolution have been the increasing popularity of Principles for Responsible Investment (PRI) and growing signatory base and launch of Climate Action 100+, an investors' initiative to promote climate action by companies. According to the Global Sustainable Investment Alliance, the assets that incorporate ESG integrations stood at US\$ 30.7 trillion in 2018, 34% higher from 2016. Globally, 75% of retail and institutional investors applied environmental, social, and governance (ESG) principles to at least a quarter of their portfolios in 2018. In India, several mutual fund houses have also launched ESG funds such as the Mirae Asset, ICICI Prudential, SBI, Axis ESG Fund, etc.

There are three key enablers behind this. First, there is a growing recognition that ESG and financial performance go

hand-in-hand. Integration of ESG issues helps investors in better managing risks and have a bearing on their returns. Recent studies have also found positive correlations between ESG metrics and their ability to create an alpha. Second, the society looks upon business to recognize and address world's economic, environmental, and social issues. There is a shift, where stakeholders now consider 'improving societal impact' as the primary purpose of an organization rather than 'generating profit'. This has been influencing investors' and organizations' choices. Lastly, increasing government and policy-makers' attention has also been driving responsible investment in several regions. 124 new or revised policy instruments across the globe on this topic were recorded in 2020 itself.

COVID-19 pandemic has put the spotlight on health, safety, and environmental protection. Such focus is also being considered as a catalyst for accelerating ESG investing. Several studies have found that responsible investments were more resilient during this time and outperformed their non-sustainable equivalents. J.P. Morgan had conducted a poll among investors from 50 global institutions, representing a total of US\$ 12.9 trillion in assets under management on how they expected COVID-19 would impact the future of ESG investing. 71% of the respondents said it was 'rather likely', 'likely', or 'very likely' that the occurrence of a risk such as the pandemic would increase awareness and actions globally to tackle high impact/ high probability risks.

IMPLICATIONS OF ESG INVESTING FOR OIL AND GAS SECTOR

As the momentum builds to act on climate change and promote clean energy transition, the investor priorities are also evolving. The Scope 1 and 2 emissions [emissions from direct fuel burning and procured energy] from the oil and





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gas sector amount to 5,300 million tCO₂e, 15% of the global energy sector emissions. At around 16 billion tCO₂e, Scope 3 emissions (various indirect emissions) account for three times the level of Scope 1 and 2 emissions. Concerned about the environmental impacts of oil and gas production and changing regulatory environment focusing on disincentivizing fossil fuels and promoting low carbon transition, investors are now seeking to reduce their contribution to climate change. They are also apprehensive about the risk of stranded assets due to change in policies, often referred to as the 'transition risk'. The validity of this concern can be seen by the fact that oil and gas companies in North America and Europe wrote down asset values of US\$145 billion in the first three quarters of 2020. Companies like Chevron and Repsol have included impairment charges of the order of US\$ 5-10 billion in their budget.

As a result, investors are considering divesting from traditional oil and gas companies and redirect their attention towards sustainable and resilient assets, such as renewables. PenSam, a Danish pension fund has removed 100 oil and coal companies from its portfolio. However, it has retained its stock in companies such as BP and Shell, which have taken action to decarbonize its operations and have invested in renewables. Another pension fund in Denmark is planning to divest its shares worth Euro 75 million in oil firms such as Chevron, Equinor, ExxonMobil, PetroChina, etc. New York Pension Fund, worth US\$ 225 billion, has announced its scrutiny of investments in this sector from an ESG lens, and may consider divesting in the future. Storebrand, a private asset manager in Norway has also removed 22 energy companies from its portfolio in the recent past. Looking at these trends, it is obvious that the oil





and gas sector is under pressure to respond to these shifts in priorities and expectations. Failure to respond may impede their investments and threaten their long-term profitability and social license to operate. However, strategic response by the sector can recover investor confidence that will sustain flow of capital.

STRATEGIC CHOICES FOR THE OIL AND GAS COMPANIES

In order to move away from the business-as-usual pathway, the oil and gas companies can implement a mix of strategies based on their geography, asset mix, prevalent regulatory environment, their capabilities, as well as potential returns on investment:

. Decarbonizing the business: Oil and gas companies have a key role in mitigating climate change by decarbonizing their operations. Actions that can be taken to reduce emissions include:

- o Integrating renewable energy in upstream operations and natural gas developments - sourcing renewable energy from the grid, such as the Johan Sverdrup field in Norway, is one of the viable options. Companies with operations in remote locations can either use natural gas or on-site renewable generation. In 2019, Equinor announced the development of an 88 MW wind facility to power its offshore platforms in the Norwegian Sea. Countries in the Middle East can explore the use of solar thermal energy for thermal EOR operations.

- o Minimizing flaring: Natural gas or associated gas is a by-product of oil production. While a large portion of the gas is utilized, remainder is flared or vented to atmosphere. As emissions from flaring make up upto 40% of the Scope 1 and 2 emissions, implementing initiatives to minimize it is a necessity⁶.

- o Reducing methane emissions: Companies should improve leak detection and repair, install vapor-recovery units, or apply other available technologies to reduce methane emissions. Reducing methane emissions and flaring has the potential to cut down 1.5 GtCO₂e per year by 2050 .

. Deploying carbon capture and storage (CCUS) technologies

- Deployment of CCUS technologies can contribute to reducing Scope 1 and 2 emission intensities of the companies. More than 51 CCUS facilities in operation or under development, which can capture and store more than 40 tCO₂e per year. By 2050, the total capacity is expected to increase by 200 times. Through investments in research and development of CCUS technologies, the sector can also scale-up its adoption and bring down costs.

. Changing business models to become integrated energy companies

- Companies can revisit their business model and diversify their operations by deploying capital towards low-carbon opportunities such as renewable energy, biofuel production, electric vehicle (EV) charging and batteries, etc. For example, Neste, an oil refiner in Finland, is one of the leading producers of renewable diesel and jet fuel . BP has installed more than 10,000 EV charging points across the United Kingdom. It also operates biofuel sites in Brazil . Similarly, Shell is also investing in biofuels, wind power, and EV charging. It is also exploring the role of hydrogen in the low carbon transformation journey of oil and gas sector . Enel and Iberdola have invested significantly in increasing its renewable energy capacity. Boardroom discussions in some of the oil and gas majors in the Gulf region also indicate serious inclinations in this direction.

CONCLUSION

Responsible financing trend all over the world has indeed created challenge for oil and gas sector to attract finance. The updated version of Equator Principle, which is based on IFC's performance standards, amended as EP4 in 2020, introduced Climate Change Risk Assessment as a requirement for certain projects, such as for project financing above US\$ 10 mln, as part of its Principle 2. Consideration by the responsible investors of such criteria will require the oil and gas sector to adopt low carbon business models for operations and growth; many companies have initiated such transformation already, signaling a clear intention of corporate stewardship to save the planet.