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Governments and companies must address climate and governance risks when petroleum assets change hands

by
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Whether driven by climate targets, reputational risk, financial considerations, or a combination of factors, some MNEs are selling petroleum assets, sometimes as part of their decarbonization strategies. However, simply selling petroleum projects may not reduce, and may actually increase, climate impacts if assets are transferred from companies with stronger environmental and reporting commitments to those with weaker commitments. Moreover, unless handled responsibly, disengagement by reputable firms may increase certain other risks for host developing countries and their citizens, such as exacerbating weak governance, corporate capture and corruption, conflict, and human rights abuses. Governments, companies, investors, and civil society should ensure that, when petroleum projects change hands, sustainability and governance standards do not slip. This may require revisiting approaches to petroleum laws and contracts and updating our understanding of company and investor social responsibility.

Host country governments should vet the quality of would-be buyers. This is not a new concept, and many governments have built related protections into their upstream petroleum legal frameworks. Contracts granting companies the right to explore for, and extract, petroleum often include restrictions on companies' ability to transfer their interest to another party. For example, all 28 English-language petroleum agreements on ResourceContracts.org[1] signed in the past five years require prior government approval for assignments of interest.[2] 23 of these specify technical and financial competence of an assignee as a condition for approval, and 25 require license holders to conduct petroleum operations in line with best industry practice.

International best industry practice for petroleum operations is evolving. Current technologies can significantly reduce emissions, and almost half of methane emissions can be avoided at no net cost. Sustainability standards and public reporting on companies' management of environmental, social and governance (ESG) impacts are also evolving. Governments should use their contractual approval rights, as well as any additional legislative or regulatory rights, to require that buyers have demonstrable competence to maintain or exceed the operating, sustainability and reporting practices of the seller, taking into consideration the most recent and robust standards for best industry practice.

Seller companies should recognize that they too have important responsibilities. Sellers may soon see limits on a "clean" exit when transferring petroleum assets to less responsible parties. Increasing attention to the environmental consequences of such asset sales may mean growing reputational risks associated with irresponsible exits, along with pushback on whether such divestments should count as part of a company's net-zero strategy. On the mining side, some legal experts have recommended that sellers conduct due diligence on buyers to assess their mission and reputation, ESG standards and adherence to international best practices, and that agreements include buyer commitments to maintain operating standards, stakeholder commitments and rehabilitation requirements. Such measures are critical for petroleum asset sales too, and sellers may build on existing approaches, such as buyer due diligence, to address anti-corruption risks. The appropriate mechanisms will depend in part on relevant laws of the applicable jurisdictions, but sellers will want to avoid the appearance of washing their hands of dirty projects to take a step forward on achieving their own net zero and ESG targets, while the host country and the planet take a step back.

Further, investors, regulators and standard-setting bodies that shape sector norms have a critical role to play in influencing company incentives and behavior. Climate disclosure and emissions reduction rules and standards must address reporting on transfers and transferred emissions. Emerging industry norms should also address broader risks associated with fossil fuel asset sales. These actors should develop standards that require sellers to conduct, and report on, due diligence on key policies and practices of buying companies, such as their environmental commitments, stakeholder engagement and measures to combat corruption internally and in engagements with high-risk partners.

Finally, civil society in host countries must hold governments and companies accountable for ensuring buyers will maintain governance and environmental standards. Civil society cannot exercise its oversight role without transparency around transfers, including the identity of sellers and buyers. The requirements of the Extractive Industries Transparency Initiative (EITI) Standard serve as a good starting point for transparency and could also be a vehicle for transparency around the types of due diligence and reporting recommended above. EITI already requires participating countries to disclose the process for transferring licenses; the technical and financial criteria used and any material deviations from such criteria; and information about transferees, including their ultimate beneficial owners. Ideally, information around transfers would be disclosed before a license is actually transferred. This will allow civil society organizations to research the reputation and performance of potential buyers and raise red flags. Indeed, disclosures and oversight before a deal is closed are key for ensuring companies and governments transfer projects responsibly.

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[1] A free online repository of almost 3,000 oil, gas and mining contracts and related documents.

[2] Assignments include changes of control in 22 of the contracts.

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