



## — OIL & GAS M&A: WHY IMPROVED ESG DUE DILIGENCE AND DATA CAPTURE ADDS VALUE

Environmental Social and Governance (ESG) considerations and climate change concerns increasingly drive public, regulatory and corporate opinion. For the oil and gas industry, this presents some challenges worth addressing.

3 MINUTE READ

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The oil and gas industry is under pressure to comply with tighter ESG regulation, especially when it comes to funding. There are also real advantages to being on top of your data in the mergers and acquisitions (M&A) process, but not every business has caught up with this. Read on to learn where your company could be missing out.

Historically, asset acquisitions in oil and gas have been supported by detailed technical, commercial and financial due diligence. Nowadays, the industry acknowledges the **new pressures** it faces to integrate ESG considerations (from investors, insurers and regulators), but as yet, these are poorly supported in terms of (a) data capture and (b) the utilisation of that ESG data, which could be used to enhance deal origination, identify transaction opportunities, and unlock downstream value-creation.

Thinking about the value of ESG data in compliance terms alone could be viewed as a merely defensive posture. Going beyond compliance, however, could enhance transaction value by baking-in better ESG data capture at the outset.

We've mapped out some opportunities in a free 'cheat sheet' you can download at the end of this article, but first, we'll expand on 10 areas where ESG data drives value but is typically under-leveraged in oil and gas **mergers and acquisitions (M&A)**.

# 10 ways to drive value through ESG in oil and gas M&A

RPS has longstanding experience in oil and gas advisory, including decades working with environmental data. (Alongside this, we support traditional subsurface and engineering disciplines and have experience conducting social programmes, including local staff recruitment and training.) Based on this history of providing support throughout the deal life cycle, the following are some of the prospects we would explore for our clients – potential opportunities to drive value in M&A through ESG:

## 1. Lower cost of capital through access to sustainable finance instruments

We are starting to see some funds or banks lowering their own risk by offering preferential interest rates for barrels with lower carbon intensity – rewarding lower carbon footprint production and investment. Conversely, ratchets can also work in the opposite direction, with the cost of your capital rising if you don't meet the agreed ESG KPIs of your loan.

## 2. More robust contract drafting and contractual security for counterparties (for example in relation to warranties)

The more you quantify in your deal, the less is put into a warranty, but warranties have been the traditional 'dumping ground' for ESG information in the past. To avoid getting tied up in warranties, which also drive up price, it makes sense to do the work on ESG due diligence instead. Warranties can then be kept at a reasonable level, transactions are smoother and pricing is clearer and more concise.

## 3. Better pricing/coverage of Warranty and Indemnity (W&I) insurance on transactions

As with the above point, being able to avoid or minimise the additional costs related to warranties is beneficial, especially for buyers. Robust due diligence means that you'll need less time on W&I insurance as there is less uncertainty on questions it covers.

## 4. Future-proofing against tighter regulatory requirements and associated costs

No one wants the kind of unforeseen circumstances that could devalue (or scupper) a deal, but even if you do have a crystal ball, due diligence is a more effective protection! One example of potentially challenging regulatory change on the horizon is the proposed [EU Corporate Sustainability Reporting Directive](#), which would require oil and gas companies to declare Greenhouse Gas (GHG) emissions and ESG strategies as if they were operating in their home territory. This would create pressure on those companies active in multiple regions with different standards, whereas preparedness through due diligence and accurate, verified reporting can help insulate against tightening regulations.

## 5. Tighter alignment with global reporting standards (e.g. SASB, GRI, TCFD)

There is no single global standard, so, depending on where you operate, you may have to stick to the terms of any one of the standards agencies. You must also ensure that you report to the standard you have nominated; getting this wrong can have additional penalties. **Some standards complement each other.**

## 6. Improved ability to navigate trending climate litigation risks and minimise exposure

As public pressure increases and funding is increasingly tied to ESG, many more **climate-related lawsuits** could be on the cards, and perhaps even class action lawsuits against oil and gas companies. ESG due diligence and being on top of governance for M&A helps ensure you avoid purchasing assets that introduce this type of risk into your portfolio.

## 7. More accurate financial quantification of climate-related risk factors under TCFD

There is now regulatory pressure on firms to quantify the financial impacts of various climate-related risks to their business. This includes both direct physical risks and so-called transition risks, which include potential costs of compliance, litigation and associated fines. A strong command of ESG data provides better visibility of where these risk factors may intersect the economic value chain of your business.

## 8. Tightening the link between Transition Planning and value-creation strategy

Thorough ESG assessment can help in the planning stage as you plot how you'll reach net zero carbon (as required by the UK government, among others). This means looking further than the financial value of barrels and asking if they are equal in ESG terms.

## 9. Tighter integration between asset selection and portfolio-level objectives/commitments

Once your transition planning is complete, a review of the company's current portfolio can be undertaken to identify the size and style of individual assets with the appropriate attributes to aid the transition journey. Both bringing in new, cleaner assets or asset types can be coupled with strategic disposals.

## 10. Improved resource for marketing content

There are opportunities for the industry to improve its reputation by publicising some of the important efforts being made on environmental and social concerns. However, there's nothing to be gained from greenwashing, both in terms of the inevitable public backlash but also because of the potential for fines and litigation. The Corporate Sustainability Reporting Directive mentioned in point 4 above, for example, will add to existing rules by bringing in "**a mandatory audit and**

**assurance regime to ensure the reliability of data** and avoid greenwashing and/or double accounting”.

There has also been negative press in the industry around ESG rating agencies who only perform desk-based assessments, with no on-the-ground verification. Increasingly, mere ‘box-ticking exercises’ won’t be enough for banks and funds requiring evidence of good governance. It can also be the case that what is happening on-site is different from what a company believes is happening, based on its policies and certifications. For these reasons, RPS takes the approach of due diligence with *verification*; using our in-house technical experts to ground truth audits in the field.

## Support for addressing oil and gas M&A challenges

A final thought to consider: banks are interested in the story of your trajectory in ESG and evidence of improvement. They aren’t looking for perfection. For example, at time of writing, ABN AMRO state that, aside from stated exceptions that are too high-risk from a sustainability perspective, “..the bank will engage with clients who do not yet meet the bank’s minimum requirements, but who are willing and able to do so within a limited timeframe”. Now is absolutely the right time to start on an ESG governance journey – and this is particularly relevant for M&A, protecting against future challenges through due diligence for today’s ESG conscious market.

RPS’ oil and gas, ESG and Deal Advisory teams liaise with vendor companies and can quickly ascertain what data gaps exist through a structured set of requests – as well as providing verification services for data claims. We can support you whether you are a buyer or a seller, prior to the marketing of an asset to ensure a smooth transaction flow, or if you are a buyer who wants to understand the ESG credentials of any given asset. We also facilitate the collection, presentation and explanation of ESG data, highlighting where and how it supports transaction value. We can also scale up our service from an asset basis if you need coverage of the full corporate sale process.