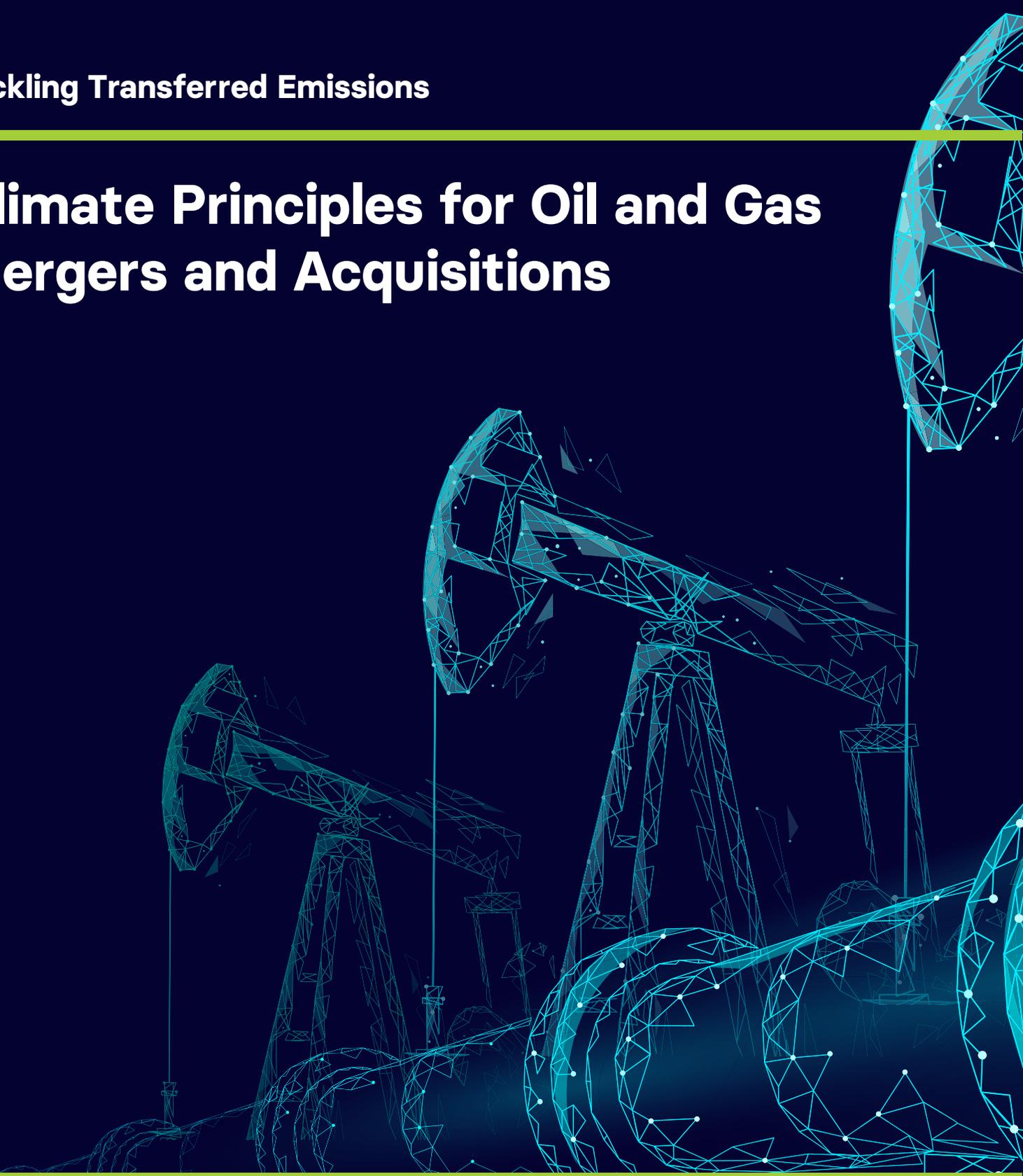




Tackling Transferred Emissions

Climate Principles for Oil and Gas Mergers and Acquisitions



Acknowledgments

Environmental Defense Fund (EDF) and Ceres are thankful for the insights provided by the many individuals who participated in roundtable discussions in relation to the Climate Principles. Their participation does not indicate agreement with the Principles.

EDF is also grateful to the Global Methane Hub for its generous support of this project. EDF and Ceres appreciate the constructive engagement from experts who contributed valuable perspectives to this paper.

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Executive Summary

Mergers and acquisitions have taken on new significance not just as a key element of business strategy but as a potential source of climate risk. Research shows that, in aggregate, upstream oil and gas assets are being transferred from companies with climate commitments and public disclosure requirements to companies without those safeguards. This means that while such transactions may help companies reach their own corporate emissions reduction targets, they do not contribute to global greenhouse gas emissions reduction—and may even result in global emissions increasing.

While transactions in the oil and gas industry can increase reputational, climate, and transition risks, they also present opportunities for industry players to lead on creating a new paradigm for oil and gas transactions that is more compatible with global net zero goals.

This report outlines ways to take advantage of these opportunities by utilizing the Climate Principles for Oil and Gas Mergers and Acquisitions, which are presented in the following four sections:

1. **Pre-Deal Due Diligence:** Diligence on acquirers should be performed prior to the initiation of deals, including an assessment of both the climate standards and the financial strength of potential buyers to manage environmental impacts. This assessment may allow for screening out of acquirers that would increase the likelihood that transferred assets lead to higher global emissions.
2. **Disclosure:** Public reporting of emissions and environmental impact should continue after transaction, and parties should make clear what portion of emissions reduction is due to transfers as opposed to other emissions reduction opportunities.
3. **Emissions Reduction Targets and Strategy:** Sellers should assist buyers in maintaining or strengthening a transferred asset's reduction targets and strategy by sharing best practices, and buyers should commit to continuity in standards when executing a purchase.
4. **Decommissioning:** Buyers should determine a plan for the decommissioning of transferred assets including the expected cost and assigned liability.

These Principles offer paths for oil and gas companies to maintain progress toward individual and collective climate goals after transfer. While they are not absolute, the Principles propose initial steps for the oil and gas industry to take in global efforts to reduce emissions.

Introduction

This report presents the Climate Principles to the oil and gas industry for incorporation into mergers and acquisitions (M&A; which should be understood as broadly covering mergers, acquisitions, divestitures, equity transactions, asset transfers, and other energy transactions) and also for further deliberation among all M&A stakeholders. These Principles will be necessary for oil and gas companies, from upstream to downstream, as the industry strives to reach its broader greenhouse gas (GHG) emissions reduction goals, which will likely introduce changes to the industry's existing way of doing business.

As oil and gas companies seek to reduce their GHG emissions to meet strengthening climate standards (including improved disclosure, target setting, planning, execution and evaluation of work to reduce emissions, and proper asset decommissioning), some have utilized divestiture as one avenue for accomplishing these goals. However, in many cases, this practice is stalling global GHG emissions reductions and increasing risk to the environment. M&A can raise money for investment in new technologies that may lead to a reduction in emissions. However, these firm-level changes in GHG emissions arising from portfolio modifications are clearly differentiated from more beneficial methods of emissions reduction that lead to both firm- and industry-level emissions reductions. Recognizing that acquisition and divestment are part of the corporate strategies of many oil and gas companies, the Climate Principles are intended to inform improved transactions.

The Principles were drafted based on roundtable discussions that included individuals representing players across the oil and gas industry, as well as other parties involved in transactions. Oil and gas companies, banks, investors, policymakers, and advisors all have opportunities to lead by utilizing and helping to further bolster and refine these Principles.

The Principles are presented in four distinct categories as follows: pre-deal due diligence, disclosure, emissions reduction targets and strategy, and decommissioning.

M&A will continue to be critical to the existence and functioning of the oil and gas industry but needs to adapt with the industry's shifting goals. Integrating these Climate Principles into asset transfers will benefit those willing to take on this challenging but critical work.

Part 1

The Transferred Emissions Challenge



Risks of Transferred Emissions

The ability to buy and sell assets is an essential ingredient of a market economy. M&A in the oil and gas industry is nothing new. Since the industry's early days, companies have bought and sold assets for a variety of reasons. In recent years, however, M&A has gained greater importance as it's become not only central to corporate strategy but also of chief concern due to its tendency to increase climate risk. Research has shown that, in aggregate, upstream oil and gas assets are being transferred from companies with climate commitments and public disclosure requirements to companies without.¹ Only 10% of oil and gas deals in 2021 openly communicated their ESG consideration in deals to stakeholders or cited ESG as a key deal rationale.² While transactions may help companies reach their own emissions reduction targets, they do not contribute to global GHG emissions reduction.

Still, these transactions are instrumental to how oil and gas companies operate, for various reasons including the following:

- Financial engineering, including the sale of assets to raise funds for debt repayment, dividend payouts, and share buybacks.
- Portfolio optimization, including the sale of assets with inadequate production, undesirable or inefficient geographic location, or those that have matured outside of the production life cycle preferred by a company.
- Consolidation across the industry, which has increased both the number and value of transactions executed.
- GHG emissions reduction strategies and energy transition planning. In some cases, this means that the capital collected from these divestments allows oil and gas companies to invest in capital-intensive energy transition spaces, including renewables, transport electrification, hydrogen, and carbon capture and storage.

To deliver a successful energy transition, M&A should take into account any associated climate impacts and should not substitute for other emissions reduction opportunities in the company's portfolio, including efficiency and operational improvements, the use of renewable power, carbon capture, managed phaseout, and permanent asset retirement. This is critical to the oil and gas industry's ability to work toward a global net zero goal and will require consideration and contribution from communities across the environment, finance, and energy sectors.

¹ Gabriel Malek, "Transferred Emissions: How Risks in Oil and Gas M&A Could Hamper the Energy Transition," ed. Andrew Baxter, Dominic Watson, and Andrew Howell, EDF+Business (EDF, May 2022), <https://business.edf.org/insights/transferred-emissions-risks-in-oil-gas-ma-could-hamper-the-energy-transition/>.

² Deloitte, "2022 Oil and Gas M&A Outlook: Rewriting the Playbook on O&G Deal-Making," Deloitte (Deloitte, January 10, 2022), <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acquisitions/2022-oil-and-gas-m-and-a-outlook.pdf>.

Why Tackling Transferred Emissions Matters

Transferring assets without considering climate impact represents reputational, climate, and transition risks for the oil and gas industry and financial institutions supporting the transactions. Investors, governments, civil society, and the media are increasingly scrutinizing these transfers and tend not to consider divestment of assets a valid decarbonization strategy, often holding the previous owner responsible for negative climate outcomes post-transfer.³

In addition, climate change poses risks for companies and financial institutions, including physical infrastructure damage, supply chain dislocations, reduced resource availability, lost productivity, commodity price volatility, and increased cost of capital. As policymakers, consumers, and companies move to tackle these issues with growing urgency, regulation of high-carbon products will significantly increase as demand decreases, augmenting financial risks for companies that hold high-emitting assets.

While transactions that consider climate impacts require additional cooperation from parties during M&A processes (including the companies, their banks, investors, and advisors), they also represent an opportunity to lead and drive innovation in transactions by including climate safeguards for players across the oil and gas industry.

The oil and gas industry should consider the goal of lowering global GHG emissions, not only corporate operational emissions, as a way of addressing reputational, climate, and transition risks. Sellers should account for the future emissions of transferred assets to faithfully fulfill their climate goals. Both sellers and buyers should demonstrate leadership on this issue to retain credibility with investors who are concerned about reputational, climate, and transition risks at the company level, as well as global emissions reductions. Additionally, those oil and gas companies adhering to stronger climate standards can directly encourage competitors within the industry to rise to the occasion as well, leading to a more level playing field.

For buyers and their public or private equity investors, the issue of transferred emissions presents an opportunity to improve emissions practices, create value, gain a competitive advantage in negotiations, and maintain access to capital. In the future, it will be prudent to ensure that these assets perform well on emissions metrics to meet expectations of future public and private shareholders. Value at exit will depend on whether the company is positioned to be profitable in a net zero future, making it key to start focusing efforts during the acquisition and early holding period.

As more banks and financial institutions adopt financed GHG emissions targets and make net zero pledges, the sale of high-emitting assets to operators with fewer targets and less stringent disclosures will be more challenging to finance and advise.

Policymakers and regulators should consider adopting directives and frameworks that prevent the transfer of emissions through M&A activity. In jurisdictions where that is unlikely or slow to occur, the oil and gas industry and financial institutions should adopt such practices and strategies to help pave the way for more robust public policy and raise the standards of the industry.

³ Bill Barnes, "Big Oil's Sales Spree to Cut Emissions May Leave Fossil Fuel Assets in Weaker Hands," Financial Times (Financial Times, July 22, 2021), <https://www.ft.com/content/3e8e9f18-7ab6-4621-9b8a-919aa4bba1ff>; Hiroko Tabuchi, "Oil Giants Sell Dirty Wells to Buyers with Looser Climate Goals, Study Finds," The New York Times (The New York Times, May 10, 2022), <https://www.nytimes.com/2022/05/10/climate/oilfield-sales-pollution.html>; Sam Meredith, "An Energy Transition Loophole Is Allowing Big Oil to Offload High-Polluting Assets to Private Buyers," CNBC (CNBC, May 19, 2022), <https://www.cnbc.com/2022/05/19/climate-how-big-oil-sells-off-polluting-assets-in-a-bid-to-look-green.html>.

Part 2

About the Principles



How the Climate Principles Were Developed

The Climate Principles for Oil and Gas Mergers and Acquisitions were developed between February and November 2022 by Ceres and EDF, in consultation with seven NGOs, seven asset managers, six private equity firms, six banks, and five oil and gas companies. The goal of the consultation process was to ensure the developed Principles would be ambitious and effective, yet practical enough to be used in real-world transactions.

There was broad agreement that such principles are needed. Some stakeholders are already implementing elements of the Principles. However, there was no firm consensus on how the Principles should be defined or how they could or should be broadly implemented.

During and after the consultation, the Principles were adapted to reflect relevant feedback and to make them more actionable. This included adding materiality thresholds, as well as ensuring a clean break for buyer and seller after the asset transfer is completed. In addition, the Climate Principles were written to provide flexible guidance to all stakeholders.

Materiality threshold: Materiality thresholds were added so that the Climate Principles aim to focus on deals that will have a meaningful impact on the seller and/or the buyer's GHG emissions.

Clean break: Both sellers and buyers agree that, after transfer, the buyer should be the sole party with the ability to determine how the asset is operated, and the seller should not have any residual liability or reporting requirement. Ongoing liabilities for the seller or restrictions that may affect the buyer's plans were seen as major barriers to adoption.

Guidance: The Principles should apply globally, i.e. in very different geographical, geologic, business, political, and regulatory contexts.

How to Transact Using the Climate Principles

Stakeholders across the finance and energy sectors have an opportunity to collaborate to encourage the application of the Climate Principles in oil and gas transactions to support industry-wide climate progress and reduce associated climate and transition risks, which lead to financial and operational risks. How the Principles are implemented in deals themselves may vary across a spectrum of options ranging from guidance leveraged by the buyer, seller, and advisors to the transaction from the early stages of negotiation with all parties involved, to enforceable clauses or covenants in a sales contract (see Appendix for sample contract provisions). Possible mechanisms across this spectrum of options will depend on regulations, disclosure regimes, and decommissioning rules in the applicable jurisdiction.

The Principles are voluntary and are not intended to serve as a comprehensive solution to oil and gas companies' transition planning. Rather, they are narrowly tailored to reduce specific climate and transition risks associated with the purchase, sale, and transfer of oil and gas assets and/or companies. We expect these Principles to complement existing climate frameworks for oil and gas – such as [IIGCC's Net Zero Standard for Oil and Gas Companies](#) – and emerging standards on managed phaseout, including that from the [Glasgow Financial Alliance for Net Zero](#).⁴ The Principles may provide indirect just transition benefits, but they do not aim or purport to offer safeguards for a just and equitable transition, an essential aspect of the road to net zero that warrants a distinct set of standards. The Principles also are not intended to supplant sensible regulation, although they may help support implementation of enhanced regulation in the future.

⁴ Dan Gardiner, "Net Zero Standard for Oil and Gas," ed. Oliver Grayer, Simon Dietz, and Rory Sullivan, IIGCC (IIGCC, September 2021), <https://www.iigcc.org/download/iigcc-net-zero-standard-for-oil-and-gas/?wpdmdl=4866&refresh=63c02a82cd1da1673538178>; GFANZ, "The Managed Phaseout of High-Emitting Assets," GFANZ (GFANZ, June 2022), https://assets.bbhub.io/company/sites/63/2022/06/GFANZ_-_Managed-Phaseout-of-High-emitting-Assets_June2022.pdf

Part 3

The Principles



Climate Principles for Oil and Gas Mergers and Acquisitions

At the core of the Principles is the belief that, along with financial considerations, the seller and the buyer should prioritize the maintenance of climate standards into the asset and capital allocation process in order to create long-term value. This means that the seller should take all reasonable steps to ensure that the buyer has the requisite incentive and financial strength to invest in emissions mitigation, manage the asset phaseout, and properly retire the asset at the end of its life, and that the buyer should demonstrate it is a responsible party that can continue to steward the asset.

The Climate Principles for Oil and Gas Mergers and Acquisitions emerge from and build on current industry best practices that some companies have adopted as part of navigating the risks and opportunities of the energy transition and addressing stakeholder concerns. They are presented in the following four sections:

1. **Pre-Deal Due Diligence:** Diligence on acquirers should be performed prior to the initiation of deals, including an assessment of both the climate standards and the financial strength of potential buyers and to manage environmental impacts. This assessment may allow for screening out of acquirers that would increase the likelihood that transferred assets lead to higher global emissions.
2. **Disclosure:** Public reporting of emissions and environmental impact should continue after transaction, and parties should make clear what portion of emissions reduction is due to transfers as opposed to other emissions reduction opportunities.
3. **Emissions Reduction Targets and Strategy:** Sellers should assist buyers in maintaining or strengthening a transferred asset's reduction targets and strategy by sharing best practices, and buyers should commit to continuity in standards when executing a purchase.
4. **Decommissioning:** Buyers should determine a plan for the decommissioning of transferred assets including the expected cost and assigned liability.

Certain principles below considered to be especially critical are bolded to encourage immediate incorporation into the M&A process.

1. Pre-Deal Due Diligence

Sellers should perform due diligence on potential buyers to ensure the new owner of the asset has the ability to, and is committed to, operating it with climate standards as strong as, or stronger than, those of the seller. Acquisition opportunities that have potential for climate and environmental harm and limited scope for improvement or risk mitigation should be screened out. These considerations should be taken in advance of or during the initial stages of deal discussions.

There are cases in which pools of buyers may be restricted by the specific situation (e.g. when the asset must be sold or surrendered to the relevant state-owned entity or government). In such cases, due diligence of buyers may not be possible.

- **Climate standards assessment:** Seller should preemptively examine the climate standards, track record (including scopes 1, 2, and 3 GHG emissions, environmental impact assessment and climate risk assessment), and emissions management plans of potential buyers to determine the potential to continue to align to relevant emissions reduction pathway over time.
- **Financial strength assessment:** Seller should preemptively examine the financial strength of potential buyers, including their ability to fulfil their climate commitments (see Emissions Reduction Targets and Strategy) and decommission the asset at the end of its useful life.
- **Technical strength assessment:** Seller should preemptively examine the ability of the potential buyer to safely operate the asset, measure, and reduce GHG emissions of that asset, and safely decommission the asset at the end of life.
- **Climate risk assessments:** Both parties should include a climate risk assessment related to the transaction in the investment memorandum and committee sign-off process.

2. Disclosure

Emissions should be measured and publicly disclosed according to accurate and consistent metrics so as to preserve high-quality disclosure across transactions, consistent with those of the seller or other prevailing industry standards. Seller and buyer should also make clear what part of emissions change is due to divestment or acquisition versus other emissions reduction opportunities.

- **Divested and acquired emissions disclosure:** In annual climate reporting, companies should disclose material changes in absolute and intensity-based GHG emissions coming from asset divestment and acquisition since the baseline emissions year, or at least going back five years. This means the seller should, for a minimum of five years, report on the divested asset emissions in the last full fiscal year the company owned the asset, and the buyer should, for a minimum of five years, report on the acquired asset emissions beginning with the first full fiscal year it owned the asset.
- **Emissions disclosure against targets:** Progress towards company emissions reduction targets that is due to asset transfers should be explained and disclosed; i.e., to what degree did asset transfers contribute to material increases or decreases in company-level emissions and how this compares to other sources of reported emissions increases or decreases.

As stakeholders evaluate companies' emissions reduction progress against targets, it is crucial that they are able to differentiate where the emissions reductions come from. The goal of the two principles above is to ensure that absolute and intensity changes in GHG emissions arising from portfolio changes (asset sales and acquisitions) are clearly differentiated from efficiency and operational improvements, use of renewable power, carbon capture, managed phaseout, permanent asset retirement, etc.

- **Transaction disclosure:** In annual reporting, companies should disclose all material deals completed during the financial year, including information on the assets that were transferred and, to the extent non-confidential, on the buyer or seller of the assets.

2. Disclosure (continued)

- **Asset emissions disclosure:** Subject to materiality considerations, absolute scopes 1 and 2 GHG emissions, as well as flaring, methane, and scopes 1 and 2 GHG emissions intensities linked to the transferred asset should be publicly disclosed by the seller for at least the last fiscal year that the company fully owned the asset, and by the buyer from the point of transaction, or from a reasonable time after. These figures may be aggregated up to company level where asset level reporting is not feasible. The seller and the buyer should both indicate the carbon accounting methodologies employed to calculate emissions.

The goal of the above principle is to ensure that emissions from the asset are contained within public reporting, in line with industry best practices.

- **Scope 3 GHG emissions disclosure:** Absolute scope 3 GHG emissions (covering the most material scope 3 emissions categories) linked to the transferred asset should be publicly disclosed by the seller for at least the last (and ideally the last three) fiscal year(s) that the company fully owned the asset. These figures may be aggregated where asset level reporting is not feasible. The seller should indicate the carbon accounting methodology employed to calculate scope 3 emissions.
- **Emissions verification:** If the seller implemented third-party verification of emissions data at the asset level or otherwise, the buyer should endeavor to achieve at least the same level of emissions data verification after the transfer.

3. Emissions Reduction Targets and Strategy

The maintenance or improvement of emissions reductions targets and strategy should provide continuity of emissions reduction efforts after the transaction and equip buyer with materials and resources to assist with emissions reduction plans and their execution.

- **Emissions reduction targets:** A transferred asset should be operated with absolute and intensity GHG emissions reduction targets (scopes 1 and 2, short-, medium- and/or long-term, including methane and flaring reduction targets) at least as ambitious as the seller's targets covering that asset, or, if similar, with the buyer's most robust targets and strategies for that class of asset. In the absence of asset-level targets, the asset should be operated after the transfer under the buyer's corporate-wide targets (reworked to account for the acquired asset if necessary) if at least as ambitious as the seller's targets covering that asset, or under newly defined targets, at least as ambitious as the seller's targets covering that asset.
- **Emissions reduction strategy:**
 - If the seller has a plan detailing the measures or options to deliver GHG emissions reduction targets for the asset (e.g., leak detection and repair program, governance, climate risk assessment and management, and marginal cost abatement curves) it should be provided to the buyer at or before closing. The buyer should endeavor to adapt this plan and implement it to deliver comparable or greater operational emissions reductions.
 - If the seller does not have an asset-specific plan, the buyer should endeavor to create one within a year of the transaction, that will lead to emissions reductions in line with set targets.

Almost universally, the buyer of an asset will have a strategy and vision for how the asset should be operated that differs from that of the seller. Thus, the seller constraining the buyer to operate an asset in a certain way is unlikely to be a workable solution. Instead, the goal of these principles is to ensure that all resources that may have been developed to manage and reduce emissions are handed over at the point of transaction so that the buyer is equipped to continue to reduce operational emissions.

Providing the emissions reduction strategy to the buyer was considered best practice by all stakeholders engaged along the process of developing the Climate Principles for Oil and Gas Mergers and Acquisitions, with recognition that the buyer will often adapt this plan after the transaction closes.

4. Decommissioning

Seller and buyer should ensure that the acquired asset is properly decommissioned at the end of its useful life. This includes plugging, abandonment, dismantling or decommissioning, the removal and capping of all infrastructure linked to the asset, environmental remediation, and restoration of the land. The principles below delineate, at the point of asset transfer, the accounting of decommissioning.

- **Determination of decommissioning funds:** The cost of retirement obligations of the transferred asset should be fully accounted for at the point of transfer, along with disclosure of the responsible party's mechanism for assuring those obligations.
 - **Decommissioning liability:** The holder or holders of the decommissioning liability should be clearly identified at the point of sale.
 - **Asset liability disclosure:** The seller should disclose the estimated non-discounted asset retirement cost, without probability adjustment.

These principles intend to make clear to all parties at the point of transfer: (i) how much decommissioning will cost, (ii) how those costs will be guaranteed, and (iii) who is responsible for proper decommissioning.

The impacts on the climate and environment from poor decommissioning practices can be significant. When not properly decommissioned, assets can pose risks to human and environmental health by leaking toxic chemicals at the surface, contaminating groundwater, and emitting methane. U.S. Environmental Protection Agency estimates that methane emissions from over 2 million inactive, unplugged wells amass to a CO₂ equivalent of 7 million metric tons annually.⁵ The industry's track record in this area in many parts of the world is poor.

⁵ EPA, "Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990-2020," EPA (U.S. Environmental Protection Agency, 2022), <https://www.epa.gov/system/files/documents/2022-04/us-ghg-inventory-2022-main-text.pdf>.

4. Decommissioning (continued)

Transferring wells during asset sales is a mechanism that can lead to a heightened risk of well orphaning as, in aggregate, wells are transferred to smaller operators who have a higher likelihood of being unable to finance decommissioning in the case of bankruptcy.⁶ In jurisdictions such as the U.S., lax idle well rules and paltry blanket bonding requirements have allowed operators to avoid plugging responsibility, which generally is ultimately transferred to the public upon bankruptcy. In some countries and jurisdictions, more robust regulation mitigates much of this risk. Regulation covering offshore UK and Norway wells are two examples. These principles are not meant to conflict with, or take precedence over, regulations in such geographies.

However, in the absence of improved regulation across much of the globe, it is incumbent upon companies committed to addressing environmental externalities related to their business to demonstrate that the assets they are buying and selling will be properly decommissioned. In the absence of doing so, the chance of proper decommissioning is far too low. M&A is a key context for companies to be conscious and proactive about this aspect of their responsibilities, which will benefit them as environmental regulation strengthens.⁷

6 Daniel Raimi et al., "Decommissioning Orphaned and Abandoned Oil and Gas Wells: New Estimates and Cost Drivers," *Environmental Science & Technology* 55, no. 15 (July 14, 2021): pp. 10224-10230, <https://doi.org/10.1021/acs.est.1c02234>.

7 Some U.S. states are taking heed of this and requiring full-cost, single-well financial assurance for marginal wells on transfer (Arkansas Oil & Gas Commission, "Arkansas Oil & Gas Commission General Rules," (Arkansas Oil & Gas Commission, May 8, 2022), <https://www.aogc.state.ar.us/Rules/rulesregs.pdf>; COGCC Staff, "Financial Assurance Rules Implementation," (Colorado Oil & Gas Conservation Commission, May 10, 2022), https://cogcc.state.co.us/documents/reg/OpGuidance/Operator%20Meetings/2022/5_May_2022/Financial_Assurance_Rules_Implementation_20220510.pdf).

Topics for Future Consideration

During the stakeholder consultation, certain additional topics led to extensive debate, signaling a need for further discussion. The below sections represent two such concepts that were debated.

Transferring scope 3 reduction targets

Scope 3 emissions account for 80 to 95% of total GHG emissions from oil and gas companies. Some oil and gas companies with large portfolios have adopted scope 3 emissions reduction targets. Ensuring that assets are operated under a scope 3 target could be a next frontier for the Climate Principles. To do so will require increased adoption of scope 3 reporting across industry, creation of finer granularity around reported scope 3 disclosure, and a protocol to compare and transfer targets when parties use different methodologies to calculate emissions. It should be added that an asset-level scope 3 target would essentially cap production and define a timeline for phaseout of that asset.

Base year emissions recalculation

To accurately account for GHG emissions reductions, the Greenhouse Gas Protocol and Ipieca provide that companies should recalculate base year emissions in the event of “structural changes in the reporting organization that have a significant impact on the company’s base year emissions,” which include “mergers, acquisitions, and divestments.”⁸ Through divested and acquired emissions disclosure, as well as emissions disclosure against targets, stakeholders should indirectly get access to the same information. Restating a company’s baseline emissions should be done in a transparent way to avoid obscuring progress against targets and preventing stakeholders from gaining an understanding of emissions reductions efforts.

⁸ Janet Ranganathan et al., “The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (Revised Edition),” GHG Protocol (World Business Council for Sustainable Development, World Resources Institute, May 2013), <https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf>; IPIECA, API, and OGP, “Petroleum Industry Guidelines for Reporting Greenhouse Gas Emissions (Second Edition),” IPIECA (IPIECA, American Petroleum Institute, OGP, May 2011), <https://www.ipieca.org/resources/good-practice/petroleum-industry-guidelines-for-reporting-greenhouse-gas-emissions-2nd-edition/>.

Conclusion

M&A is a critical tool for oil and gas companies and is likely to remain a prominent feature of the industry in the future. Yet these deals introduce reputational, climate, and transition risks due to the varying degree to which oil and gas companies have implemented climate standards. Overall, the majority of transactions completed over the past five years have involved assets moving from owners that have more robust plans to reduce and report emissions to those with weaker standards, resulting in risks of global emissions decreases from this industry stalling or increasing.

However, these deals present an opportunity for leadership on climate risk. Oil and gas companies can prove themselves responsible stewards of capital by incorporating long-term thinking into transactions via the Climate Principles for Oil and Gas Mergers and Acquisition. Potential buyers can differentiate themselves and create value by incorporating climate considerations into deal terms. Investors and advisors, including lawyers and bankers, can achieve their GHG emissions reduction targets, lead the transition, and gain experience in a more sustainable and forward-looking way of doing business through thoughtfully executed M&A.

While the Principles address both risks and opportunities for players in the oil and gas industry, they need not be limited to one segment of the market. Indeed, they may set a precedent for controlling risks associated with transactions in other high-emitting industries.

Next Steps

While the Climate Principles for Oil and Gas Mergers and Acquisitions outline ways that players within the oil and gas industry can take a leadership role through the M&A process, these Principles may introduce friction initially and should be a catalyst for further discussion. Stakeholder consultation through roundtable discussions led to careful revision of the Principles to encourage their rapid adoption. Further updates are expected as the industry strengthens climate standards. Future roundtable discussions will be most fruitful with the attention of all stakeholders, including private and public equity investors, banks, advisors, and the transacting companies.

M&A will continue to be a crucial tool for companies in the oil and gas industry. Yet in their current form, these transactions continue to threaten global emissions reduction goals. Firms looking to lead the industry in the future should both take up these Principles and join the conversation to continuously strengthen them.

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Appendix

Sample Contract Provisions



Through the roundtable discussions, we were asked to include concrete examples of how these Principles could be implemented. How the Principles are implemented in deals themselves may vary across a spectrum of options ranging from socialization of the Principles at the early stages of negotiation and making them part of the discussion early on and with all parties involved, to advice among the buyer, seller and advisors to the transaction, all the way to enforceable clauses or covenants in a sales contract. Below are illustrative sample contract provisions that could be helpful for parties choosing the last option.

Disclaimer

These provisions are not intended to be used in actual asset purchase agreements or other contracts as presented here without prior independent legal review on behalf of the party consulting them as to, among other things, their legal effect in such contracts, the applicability of laws and regulations in the relevant jurisdictions, or the strategic goals of the parties to the agreements. By providing these sample provisions, Ceres and the Environmental Defense Fund make no representations or warranties about their appropriateness, completeness, relationships with other contractual provisions, enforceability, or legal effect.

Emissions Reporting

A. Seller Emissions Disclosures

Seller has made available to Buyer the following information on Seller's Disclosure Schedules:

- a. Schedule E-1: Absolute Scope 1 and Scope 2 GHG emissions attributable to the Assets during Seller's most recent completed fiscal year. [Alternatives: The GHG emissions on Schedule E-1 have been verified by [certification organization] according to the carbon accounting protocol set out in Schedule F-1. OR The GHG emissions on Schedule E-1 were determined according to the carbon accounting protocol set out in Schedule E-2 but have not been verified by a third-party verification organization.]
- b. Schedule E-3: Flaring GHG emissions attributable to the Assets during Seller's most recent completed fiscal year. [Alternatives: The flaring GHG emissions on Schedule E-3 have been verified by [certification organization] according to the carbon accounting protocol set out in Schedule F-2. OR The flaring GHG emissions on Schedule E-3 were determined according to the carbon accounting protocol set out in Schedule E-4 but have not been verified by a third-party verification organization.]
- c. Schedule E-5: Methane emissions attributable to the Assets during Seller's most recent completed fiscal year. [Alternatives: The methane emissions on Schedule E-5 have been verified by [certification organization] according to the carbon accounting protocol set out in Schedule F-3. OR The methane emissions on Schedule E-5 were determined according to the carbon accounting protocol set out in Schedule E-6 but have not been verified by a third-party verification organization.]
- d. Schedule E-7: Scope 1 and Scope 2 GHG emissions intensities attributable to the Assets during Seller's most recent completed fiscal year. [Alternatives: The GHG emissions intensities on Schedule E-7 have been verified by [certification organization] according to the carbon accounting protocol set out in Schedule F-4. OR The GHG emissions intensities on Schedule E-7 were determined according to the carbon accounting protocol set out in Schedule F-4 but have not been verified by a third-party verification organization.]

- e. Schedule E-9: Absolute Scope 3 GHG emissions attributable to the Assets during Seller's most recent three completed fiscal years (or for all of the most recent completed fiscal years if Seller has owned the Assets for fewer than three completed fiscal years). [Alternatives: The GHG emissions on Schedule E-9 have been verified by [certification organization] according to the carbon accounting protocol set out in Schedule F-5. OR The GHG emissions on Schedule E-9 were determined according to the carbon accounting protocol set out in Schedule E-10 but have not been verified by a third-party verification organization.]

The emissions and emissions intensities set out in Schedules E-1, E-3, E-5, and E-7 are referred to collectively as Seller's Absolute and Intensity Scope 1 and Scope 2 Emissions Amounts.

B. Seller Emissions Representations

Seller represents that to Seller's Knowledge, any statements publicly disclosed by Seller concerning Seller's Absolute and Intensity Scope 1 and Scope 2 Emissions Amounts are accurate in all material respects and in compliance in all material respects with all Legal Requirements of [insert appropriate Governmental Authorities with jurisdiction over such statements], and all Environmental Laws.

C. Buyer Acknowledgements

Buyer acknowledges that, except for the information publicly disclosed by Seller or otherwise within the public domain, the information contained in Schedules E-1 through E-10 may be confidential business information of Seller. Without prior written consent by Seller (which may be withheld in Seller's sole discretion), such information shall be held confidential by Buyer and Buyer's Representatives in accordance with the terms of the Confidentiality Agreement.

Buyer acknowledges and affirms that it has made, and prior to Closing will make, its own independent investigation, analysis, and evaluation of the information disclosed by Seller on Exhibits E-1 through E-8 [and on Schedules F-1 through F-4]. Buyer acknowledges that in entering into this Agreement, it has relied on the aforementioned independent investigation. Buyer acknowledges and agrees that Buyer cannot rely on or form any conclusions from Seller's methodologies for the determination and reporting of Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Amounts that have not been verified by a third-party verification organization, it being understood that Buyer must make its own determination as to the proper methodologies that can or should be used for any reporting by Buyer of its absolute and intensity Scope 1 and Scope 2 GHG emissions amounts, flaring GHG emissions amounts, and methane emissions amounts after the Closing Date.

D. Buyer Emissions Reporting Covenant

If the Closing occurs, for five years beginning with Buyer's first full fiscal year after the Closing Date, Buyer shall report on an annual basis its (a) absolute Scope 1 and Scope 2 GHG emissions attributable to the Assets; (b) flaring GHG emissions attributable to the Assets; (c) methane emissions attributable to the Assets; and (d) Scope 1 and Scope 2 GHG emissions intensities attributable to the Assets on [a mutually agreed publicly available reporting platform]. Such reports shall be made no later than [time period] after the completion of Buyer's fiscal year.

Sample Emissions Reduction Provisions

A. Seller Emissions Reduction Disclosures

Seller has made available to Buyer the following information on Seller's Disclosure Schedules:

- a. Schedule E-11: Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets for the Assets.
- b. Schedule E-12: Seller's GHG Emissions Reduction Plan for the Assets.

B. Seller Emissions Reduction Representations

Seller represents and warrants to Buyer as of the Execution Date and the Closing Date, since [relevant date(s)], the Assets have been developed and operated by Seller in material compliance with Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets and Seller's GHG Emissions Reduction Plan for the Assets. Seller grants Buyer and any of Buyer's successors in interest an irrevocable license to use Seller's GHG Emissions Reduction Plan for the Assets as provided in [Section _]. Notwithstanding the previous sentence, Seller is providing Seller's GHG Emissions Reduction Plan for the Assets as a courtesy to Buyer and any of Buyer's successors in interest, and it makes no representation or warranty that Seller's GHG Emissions Reduction Plan for the Assets, if properly implemented, will achieve Seller's Absolute or Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets.

C. Buyer Acknowledgements

Buyer acknowledges that, except for the information publicly disclosed by Seller or otherwise within the public domain, the information contained in Schedules E-11 through E-12 may be confidential business information of Seller. Without prior written consent by Seller (which may be withheld in Seller's sole discretion), such information shall be held confidential by Buyer and Buyer's Representatives in accordance with the terms of the Confidentiality Agreement.

Buyer acknowledges and affirms that it has made, and prior to Closing will make, its own independent investigation, analysis, and evaluation of the information disclosed by Seller on Exhibits E-11 and E-12, including Buyer's own estimate and appraisal of the extent and value of the Assets and an independent assessment and appraisal of the consequences to the extent and value of the Assets of developing and operating the Assets subject to Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets for the Assets, or equivalent or greater targets, or Seller's GHG Emissions Reduction Plan for the Assets, or an equivalent or more ambitious plan. Buyer acknowledges that in entering into this Agreement, it has relied on the aforementioned independent investigation.

Exhibits E-11 and E-12, including Buyer's own estimate and appraisal of the extent and value of the Assets and an independent assessment and appraisal of the consequences to the extent and value of the Assets of developing and operating the Assets subject to Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets for the Assets, or equivalent or greater targets, or Seller's GHG Emissions Reduction Plan for the Assets, or an equivalent or more ambitious plan. Buyer acknowledges that in entering into this Agreement, it has relied on the aforementioned independent investigation.

Alternative Emissions Reduction Mechanisms

D1. Buyer Emissions Reduction Covenant (with reporting)

If the Closing occurs, Buyer shall develop and operate the Assets in a manner that achieves absolute and intensity Scope 1 and Scope 2 GHG emissions reductions equivalent to or greater than the greater of (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; and (b) Buyer's own GHG emissions reduction target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

Beginning with Buyer's first full fiscal year after the Closing Date, Buyer shall report on an annual basis on [a mutually agreed publicly available reporting platform] its progress toward meeting (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; or (b) Buyer's own GHG emissions reduction target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

D2. Buyer Emissions Reduction Covenant (with reporting and specific performance)

If the Closing occurs, Buyer shall develop and operate the Assets in a manner that achieves absolute and intensity Scope 1 and Scope 2 GHG emissions reductions equivalent to or greater than the greater of (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; and (b) Buyer's own GHG emissions reduction target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

Beginning with Buyer's first full fiscal year after the Closing Date, Buyer shall report on an annual basis on [a mutually agreed publicly available reporting platform] its progress toward meeting (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; or (b) Buyer's own target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

For as long as Buyer owns or operates the Assets, Buyer's covenant in this Section shall survive indefinitely without limitation as to time. The parties agree, because damages would be an inadequate remedy, that if Seller seeks to enforce this Section, it shall be entitled to seek specific performance and injunctive relief as remedies for any breach thereof in addition to other remedies available at law or in equity. In the event of a material breach of Buyer's obligations in this Section that is not cured within [sixty (60)] days following written notice by Seller to Buyer of such breach, then Seller may, by written notice to Buyer, elect to enforce specific performance of Buyer's obligations under this Section by filing the appropriate documents to commence litigation following expiration of the cure period.

If Buyer sells or otherwise conveys the Assets to any person or entity, Buyer shall include in the conveyance agreement an obligation by Buyer's successor in interest to comply with the same operations and reporting covenants set out in this [Section _], including Seller's right to seek specific performance of such covenants.

D3. Buyer Emissions Reduction Covenant (with reporting and specific performance, including by third party beneficiaries)

If the Closing occurs, Buyer shall develop and operate the Assets in a manner that achieves absolute and intensity Scope 1 and Scope 2 GHG emissions reductions equivalent to or greater than the greater of (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; and (b) Buyer's own GHG emissions reduction target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

Beginning with Buyer's first full fiscal year after the Closing Date, Buyer shall report on an annual basis on [a mutually agreed publicly available reporting platform] its progress toward meeting (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; or (b) Buyer's own GHG emissions reduction target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

For as long as Buyer owns or operates the Assets, Buyer's covenant in this Section shall survive indefinitely without limitation as to time. The parties intend that Buyer's covenant in this Section shall be enforceable by Seller and also by the list of third-party beneficiaries set out in Schedule E-13. Any third party identified on Schedule E-13 is intended to be a third-party beneficiary only with respect to Buyer's covenant in this Section and not with respect to any other provision of this Agreement. The parties agree, because damages would be an inadequate remedy, that if Seller or any third-party beneficiary identified on Schedule E-13 seeks to enforce this Section, it shall be entitled to seek specific performance and injunctive relief as remedies for any breach thereof in addition to other remedies available at law or in equity. In the event of a material breach of Buyer's obligations in this Section that is not cured within [sixty (60)] days following written notice by Seller or any third-party beneficiary identified on Schedule E-13 to Buyer of such breach, then Seller or such third-party beneficiary may, by written notice to Buyer, elect to enforce specific performance of Buyer's obligations under this Section by filing the appropriate documents to commence litigation following expiration of the cure period.

If Buyer sells or otherwise conveys the Assets to any person or entity, Buyer shall include in the conveyance agreement an obligation by Buyer's successor in interest to comply with the same operations and reporting covenants set out in this [Section _], including the right of Seller or any third-party beneficiary identified on Schedule E-13 to seek specific performance of such covenants.

D4. Buyer Emissions Reduction Covenant (with reporting and specific performance, including by third party beneficiaries, and a restrictive covenant binding subsequent buyers)

If the Closing occurs, Buyer shall develop and operate the Assets in a manner that achieves absolute and intensity Scope 1 and Scope 2 GHG emissions reductions equivalent to or greater than the greater of (a) the emissions reductions set out in Seller's Absolute and Intensity Scope 1 and Scope 2 GHG Emissions Reduction Targets; and (b) Buyer's own GHG emissions reduction target covering the same class of asset as the Assets, adjusted to include or otherwise account for the Assets.

For as long as Buyer owns or operates the Assets, Buyer's covenant in this Section shall survive indefinitely without limitation as to time. The parties intend that Buyer's covenant in this Section shall be enforceable by Seller and also by the list of third-party beneficiaries set out in Schedule E-13. Any third party identified on Schedule E-13 is intended to be a third-party beneficiary only with respect to Buyer's covenant in this Section and not with respect to any other provision of this Agreement. The parties agree, because damages would be an inadequate remedy, that if Seller or any third-party beneficiary identified on Schedule E-13 seeks to enforce this Section, it shall be entitled to seek specific performance and injunctive relief as remedies for any breach thereof in addition to other remedies available at law or in equity. In the event of a material breach of Buyer's obligations in this Section that is not cured within [sixty (60)] days following written notice by Seller or any third-party beneficiary identified on Schedule E-13 to Buyer of such breach, then Seller or such third-party beneficiary may, by written notice to Buyer, elect to enforce specific performance of Buyer's obligations under this Section by filing the appropriate documents to commence litigation following expiration of the cure period.

If Buyer sells or otherwise conveys the Assets to any person or entity, Buyer shall include in the conveyance agreement an obligation by Buyer's successor in interest to comply with the same operations and reporting covenants set out in this [Section _], including the right of Seller or any third-party beneficiary identified on Schedule E-13 to seek specific performance of such covenants.

The parties also intend that Buyer's covenants in this [Section _] shall be obligations that run with the land. At or before the Closing Date, Seller will file the form of Restrictive Covenant set out in Schedule E-14 in the real property records in each jurisdiction in which the Assets are located. Buyer acknowledges and consents to the filing such Restrictive Covenants.