



Money to burn?

Cutting methane emissions sharply this decade is vital for keeping global heating within 1.5°C, buying crucial time for the transition to a low carbon economy. How are we engaging with oil and gas companies, pipeline operators, energy users and banks to help address this key issue?

Setting the scene

Methane accounts for about 20% of global greenhouse gas emissions, but is more effective than carbon dioxide at trapping heat in the atmosphere over the short term.¹ So curbing methane emissions this decade would buy valuable time for big carbon-emitting sectors to find viable solutions. Scientists say this is required to keep the Paris Agreement goal of 1.5°C within reach and ultimately help to avert catastrophic heating.

The importance of methane as an effective short-term lever is recognised in key industry scenarios. The International Energy Agency's Net Zero scenario assumes a 75% fossil fuel methane emissions reduction by 2030 and the Oil & Gas Methane Partnership (OGMP) calls for a 45% emissions reduction by 2025 relative to 2015 levels, with a 60-75% reduction by 2030.

For further information please contact:



Diana Glassman
Sector lead: Oil & Gas
diana.glassman@hermes-investment.com

Reducing methane emissions this decade is probably the single most important action the world can take to reduce the rate of global heating. Methane warms the planet about 80 times more effectively than CO₂ over 20 years, but after about a decade starts to dissipate.^{2,3} Making swift reductions in methane would curb rising temperatures more quickly than carbon dioxide cuts in the short term. This buys time for hard-to-abate sectors to find viable technological solutions for their carbon emission problem, helping to keep 1.5°C of heating within reach.

The importance of methane was recognised at COP26 when the US and EU announced a partnership to cut methane emissions by 30% by 2030, from 2020 levels.⁴ Over 100 countries signed up to the Global Methane Pledge, acknowledging the urgency of the issue. The latest global heating forecast from the World Meteorological Organization and the UK Met Office underscored that time was running out, with a 48% chance we will exceed 1.5°C within the next five years because of record greenhouse gas levels.⁵ This raises the risk of deadly wildfires, extreme heatwaves running at above 50°C, and the flooding of major cities.

¹ Methane is the second most-trapping heat in the atmosphere.

² Reduce methane or face climate catastrophe, scientists warn | Greenhouse gas emissions | The Guardian.

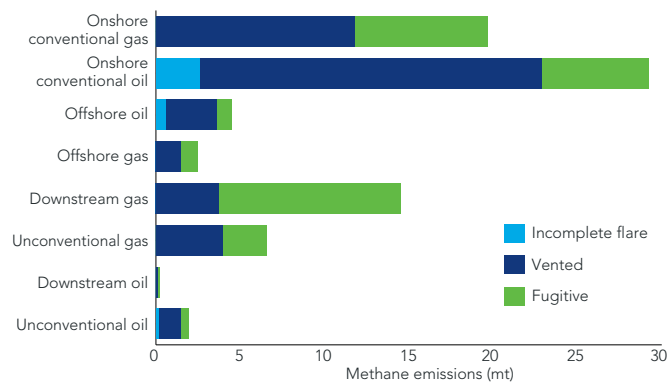
³ <https://www.nationalgeographic.com/environment/article/methane>.

⁴ <https://www.bbc.co.uk/news/world-59137828>.

⁵ World on course to breach global 1.5C warming threshold within five years | Financial Times (ft.com)

Unfortunately, methane emissions are an inconsistently reported investment risk and climate issue, and while agriculture is responsible for about 42% of methane emissions, the energy sector accounts for 38%.⁶ Oil and gas extraction, processing and distribution contributes 23% of the global total, while coal mining accounts for 12%, according to UNEP’s Global Methane Assessment.⁷

Annual oil and gas sector methane emissions by production type and reason, million tonnes



Source: IEA (2020), as cited in UNEP’s Global Methane Assessment.

UNEP highlights that there are readily available measures to reduce methane emissions by 30% by 2030 – nearly half of which are available to the fossil fuel sector. Encouragingly, 60-80% of the options to curb leaks from the oil and gas sector are low cost, and in some cases, there is an upside. “The greatest potential for negative cost abatement is in the oil and gas subsector where captured methane adds to revenue,” UNEP states.

Reducing methane emissions also has a social benefit. Methane has deleterious health impacts, contributing to premature deaths, asthma-related hospital visits due to the formation of ozone at ground-level, and lost labour due to extreme heat. Curbing methane emissions to mitigate

climate change, which disproportionately impacts those least able to adjust to it, would help to avoid exacerbating existing inequities.

Pinpointing methane leaks to identify the worst global emitters can be tricky and relies on satellite data, but Russia’s Gazprom has admitted responsibility for some of the biggest leaks in recent years.⁸ The World Bank’s 2022 Global Gas Flaring Tracker Report, released in May, showed that Russia, Iraq, Iran, the US, Algeria, Venezuela and Nigeria accounted for two-thirds of global gas flaring 10 years running.⁹ The top 10 countries have all committed to the World Bank’s Zero Routine Flaring by 2030 Initiative, whereby governments and companies pledge not to routinely flare gas in any new oil field development, and to end routine flaring in existing oil fields as soon as possible and no later than 2030. However, over the past decade, only the US has improved the flaring intensity of its oil production, the World Bank notes.

UNEP highlights that there are readily available measures to reduce methane emissions by

30%

by 2030 – nearly half of which are available to the fossil fuel sector.

According to the report, some 144 billion cubic metres of gas was wastefully burnt in flares at upstream oil and gas facilities across the globe in 2021.¹⁰ This is equivalent to 93% of Europe’s gas purchases from Russia, according to an analysis by Capterio.¹¹ However, due to Russia’s invasion of Ukraine, the EU is aiming to end its reliance on Russian fossil fuels by boosting renewables, making energy savings and diversifying its sources of supply.¹²

Unfortunately, methane emissions are an inconsistently reported investment risk and climate issue, and while agriculture is responsible for about

42% of methane emissions, the energy sector accounts for **38%**

⁶ Why Slowing Methane Leaks Is Critical to Climate Fight (bloomberg.com).

⁷ <https://www.unep.org/resources/report/global-methane-assessment-benefits-and-costs-mitigating-methane-emissions>.

⁸ Gazprom Admits to Massive Methane Leaks - Bloomberg.

⁹ <https://www.worldbank.org/en/topic/extractiveindustries/publication/2022-global-gas-flaring-tracker-report>.

¹⁰ <https://www.worldbank.org/en/topic/extractiveindustries/publication/2022-global-gas-flaring-tracker-report>.

¹¹ New flaring data shows unacceptable flatlining and boldens the imperative to act | FlareIntel.

¹² EU unveils €300bn plan to quit Russian fossil fuels by 2027 and boost clean energy (climatechangenews.com).



Our engagement approach

Given the financial upside on offer, investors and their representatives should urge companies to reduce their methane emissions, and the need to act this decade means that senior executives can be more easily held to account. For example, we can push for the inclusion of methane reduction targets in executives' short-term compensation structures.

Tackling methane emissions through engagement is not a new focus for us,¹³ but we have been able to leverage the greater awareness post-COP26 to help galvanise industry efforts. Under our Engagement Plan, we are seeking a 60-75% reduction in oil and gas operational methane emissions by 2030, from a 2015 baseline.

Under our Engagement Plan, we are seeking a

60-75%

reduction in oil and gas operational methane emissions by 2030, from a 2015 baseline.

Specifically, we ask for methane reduction commitments and implementation plans aligned with the UNEP-managed Oil & Gas Methane Partnership (OGMP) 2.0 to achieve a critical near-term outcome that progresses longer-term decarbonisation objectives. We were an early supporter of the OGMP 2.0, which offers a step-change improvement in the transparency and credibility of reported methane emissions from oil and gas operations. Alignment with the OGMP must be a priority for producers given that it is in their own financial interest, with implications for directors' fiduciary responsibilities and sustainable wealth creation for investors.

Why does so much methane escape?

Early adopters of methane management will have benefitted from a competitive edge – so why have others been slow to follow? Billions of dollars a year are still wasted by companies choosing flaring or venting over capture and recovery.¹⁴

- Flaring occurs when producers deliberately burn gas rather than capturing and transporting it for use. One major overlooked source of emissions is the flaring of excess gas that is concurrently produced with oil.
- Venting is when methane is deliberately released into the atmosphere, sometimes as a safety measure to prevent pressure building up, reducing the risk of an explosion. Given the current scramble for alternatives to Russian gas, capturing this wasted methane would add vital supply and help to bring down gas prices for struggling households and businesses.
- Methane can also escape through leaky pipes or faulty equipment – so-called “fugitive emissions”. Pneumatic pumps and controllers, which tend to be used in areas where electricity is not readily available, can be one of the largest sources of methane emissions.¹⁵

In our engagements with upstream oil and gas companies – the producers – we ask them to make every effort to reduce flaring, venting and fugitive emissions. Leaks can be detected through regular testing and maintenance, for example, while the installation of solar panels can help to replace pneumatic equipment.

Midstream's key role

The midstream companies operating the pipelines transporting the oil and gas to the customer also have a vital role to play. There are roughly 100 midstream companies in North America, but they have been an under-tapped lever for change. We have engaged directly with companies such as Kinder Morgan, Enbridge and TC Energy. In line with OGMP 2.0's leading methane targets, we ask midstream players to reduce planned and unplanned maintenance venting, identify and address fugitive emissions, and plug pipeline leaks in a timely manner.

For example, Kinder Morgan is a leading player within a slow industry, and we have urged the company to do more to accelerate the pace of change. We asked it to set an example by joining the OGMP 2.0, which we believe is the gold standard in disclosure for investors, and to encourage trade associations such as ONE Future to align with OGMP 2.0.

This segment of the market can also impact Scope 3 supply chain emissions by putting pressure on producers. Pipeline operators often have direct influence over what goes into their pipe, and upstream flaring practices. We encourage pipeline operators to ask their upstream business partners to align with OGMP 2.0, and to disclose the emissions intensity of the fossil fuels they carry as part of their Scope 3, as Enbridge does.

We welcomed Enbridge's development of this meaningful metric, which focuses attention on the behaviours that upstream and midstream players can adopt to accelerate methane emissions reductions. As Enbridge's metric is based on geographic upstream emissions estimates, we are asking Enbridge and the industry to work towards disclosing upstream providers' actual aggregate emissions.

¹³ [Investor sees methane management as self-help for oil and gas companies \(edf.org\).](https://www.edf.org/)

¹⁴ <https://www.nytimes.com/2019/10/16/climate/natural-gas-flaring-exxon-bp.html>.

¹⁵ <https://methaneguiderprinciples.org/best-practice-guides/pneumatic-devices/>.



CASE STUDY

Occidental Petroleum



In 2018, we asked Occidental Petroleum to set emissions targets, including methane targets, as part of our feedback on the company's first climate change report. We queried how climate change was factored into the Anadarko Petroleum acquisition, given the company's growth mindset at a time when we may be reaching peak oil demand. The subsequent pandemic and US\$9bn write down elevated these concerns.

In 2019, the company established initial Scope 1 and 2 emissions targets. In 2020, it became the first US oil and gas company to announce net-zero targets, including methane targets to end routine flaring by 2030, covering its entire business footprint, including Scope 3. The development of carbon capture, utilisation and storage (CCUS) technologies was expected to offset approximately 20 million tons annually while expanding the capacity for more. We sought clarity on the risks and uncertainties associated with CCUS, which is critical for the low-carbon transition, but should not be a substitute for phasing out fossil fuels.

The company emphasised its 50-year track record of CCUS and said it accounted for the added sustainability benefits when evaluating the economics. It also established additional short-term (2024) and medium-term (2032) targets, endorsed the OGMP 2.0, commissioned independent limited assurance verification for its Scope 1 and 2 emissions, and published its climate public policy positions. We will continue to engage with the company, focusing on the risks and uncertainties associated with CCUS.



Nick Pelosi
Sector co-lead: Mining & Materials
nick.pelosi@hermes-investment.com

In an engagement with us, Enbridge said that it was analysing the OGMP 2.0 reporting framework, seeing many opportunities to work with the upstream and downstream. It is working closely with jurisdictions to develop stronger regulatory frameworks following COP26 and the Global Methane Pledge.

We have also championed collaborative, cross-sector action. In March 2022, we convened separate meetings with representatives from Kinder Morgan and Ceres' Climate Action 100+ lead, plus the Energy Infrastructure Council (EIC), a trade association, and the Environmental Defense Fund (EDF), a non-profit environmental advocacy group.

Together, we discussed ideas to advance midstream-specific metrics and solutions. There was broad agreement around the need for a collaborative multi-stakeholder process involving the banking sector to generate midstream investor expectations. We have engaged with banks such as Citi and JPMorgan encouraging them to ask their upstream clients to address methane emissions and align with OGMP 2.0 as part of their energy transition plans.

Big users of oil and gas, such as utilities, cement manufacturers and petrochemical companies, should also be demanding transparency from upstream suppliers on this issue, given the slow pace of mitigation to date and the limited timescale in which to act.

We helped to set up a collaborative Climate Action 100+ midstream roundtable on methane attended by midstream companies and investors, alongside the EIC and the GPA Midstream Association. Investors reiterated the importance of energy transition plans with timelines and targets, aligning with the OGMP 2.0 reporting framework, and supporting methane regulations. Companies described their key initiatives to cut methane emissions. For example, Kinder Morgan said that it focused on reducing venting from pipeline repair or testing activities and leaks at compressor stations.

Big users of oil and gas, such as utilities, cement manufacturers and petrochemical companies, should also be demanding transparency from upstream suppliers on this issue, given the slow pace of mitigation to date and the limited timescale in which to act.





CA100+ Midstream Oil & Gas Working Group

In 2021 we contributed to the Climate Action 100+ Midstream Oil & Gas Working Group's Investor Recommendations for a Net-Zero Aligned Strategy. These provide additional nuance to the CA100+ benchmark for North American midstream companies.

The guidance for midstream companies lays out investor expectations regarding Scope 1, 2 and 3 net-zero commitments by 2050 or sooner, as well as on targets, decarbonisation strategy, capital alignment, climate policy engagement, climate governance, just transition and TCFD disclosure.

In developing these investor expectations, the Ceres midstream Oil and Gas Working Group built on the top 10 asks that we marshalled in a letter co-signed by 17 signatories. We sent this to Kinder Morgan in September 2020 as a co-lead for the company under CA100+.

In developing these investor expectations, the Ceres midstream Oil and Gas Working Group built on the top

10 asks that we marshalled in a letter co-signed by 17 signatories.



The guidance also incorporates our view that midstream players should consider the emissions from the products transported; adopt responsible customer/supplier practices related to water use, labour standards and community impacts; and describe their policies for dealing with indigenous peoples and the relevant standards applied. These could include free, prior, and informed consent (FPIC) and the UN Universal Declaration of Human Rights. We are currently exploring a multi-stakeholder initiative with Ceres, EDF, midstream companies and trade associations, plus banks, to develop fresh guidance.

Encouragingly, the OGMP 2.0 is gaining traction, with Occidental Petroleum and EQT among the signatories, and we are urging ConocoPhillips, Chevron (see box), Kinder Morgan, Enbridge and TC Energy to sign up. We also discussed the importance of aligning with OGMP 2.0 with energy industry certifiers Equitable Origin and Rocky Mountain Institute-affiliated MiQ.

On the public policy advocacy front, we submitted a comment letter on the US Environmental Protection Agency's proposed rule on US oil and gas sector methane emissions for new and existing sources. We expressed support for strong methane emissions performance standards and endorsed the OGMP 2.0 disclosure framework.

We submitted a comment letter on the US Environmental Protection Agency's proposed rule on US oil and gas sector methane emissions for new and existing sources.



In the letter, we stated our principles-based position, including that the rule should enhance reporting transparency, credibility and comparability. We said that regulation should promote best operating practices such as advanced leak detection and the use of zero-emitting pneumatic controllers, while reducing the wasteful practice of routine flaring. It should also improve public health and safety, and environmental justice, addressing orphaned and abandoned wells, and requiring states to engage with the public and industry.

In May, we participated in an S&P webinar about investor action on methane. Alongside participants from the EDF, we discussed the role that shareholders and industry could play, as well as how to measure the impact of methane on net-zero emissions targets. We have also spoken on methane at an in-person oil and gas conference at the New York Stock Exchange hosted by the Energy Council in May, and at an ESG in Energy Conference in Houston, hosted by the Corporate Council Business Journal in April.

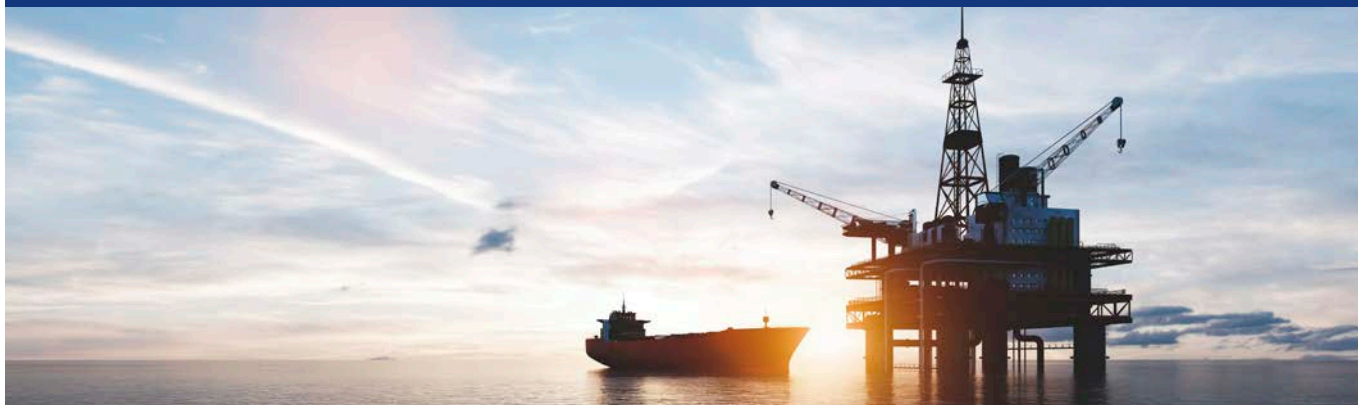
Regulation should promote best operating practices such as advanced leak detection, while reducing the wasteful practice of routine flaring.





CASE STUDY

Chevron



We discussed OGMP 2.0 in a March 2022 engagement with US oil major Chevron. Although the company said it did not expect to join until better technology was available, thus enabling it to adhere to a commitment, we urged it to consider joining sooner. Chevron believes that customer demand and certifications can help to drive methane reduction.

In May, EOS filed an exempt solicitation with the US Securities and Exchange Commission urging shareholders to support the recommendation by Chevron's board that investors vote for a shareholder proposal for a report on the reliability of methane emission disclosures.¹⁶

We had urged the board to support this shareholder proposal during engagement prior to the publication of the proxy. During in-person meetings with the company's ESG manager and corporate secretary, we said that supporting a shareholder proposal would be an opportunity to demonstrate leadership in corporate governance best practice, and greater accuracy in methane emissions measurement and disclosure.

The board's action contrasted favourably with the prevailing tendency of oil and gas company boards to oppose shareholder proposals, even in situations where they are substantively consistent with a company's own stated goals and with long-term value creation. The proposal, which focused on improving the accuracy and reliability of methane emissions reporting, progresses our Engagement Plan objective of slashing oil and gas sector methane emissions by 75% by 2030. At the meeting, 98% of shareholders voted in support.

While we continue to engage on multiple areas where the company has room for improvement, we welcomed the board's decision to support this shareholder proposal.

At the meeting,

98% of shareholders voted in support.



Outlook

We will continue to engage with companies and policymakers to encourage a switch to renewable energy, and an overall reduction in demand for fossil fuels. In parallel, we will push fossil fuel companies and trade associations to develop collaborative solutions that reduce actual methane emissions and have a real near-term impact on climate outcomes.

¹⁶ <https://www.sec.gov/Archives/edgar/data/93410/000162363222000596/form.htm>.



Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important strategies from the entire group.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

For more information, visit www.hermes-investment.com or connect with us on social media:



For professional investors only. This is a marketing communication. Hermes Equity Ownership Services (“EOS”) does not carry out any regulated activities. This document is for information purposes only. It pays no regard to any specific investment objectives, financial situation or particular needs of any specific recipient. EOS and Hermes Stewardship North America Inc. (“HSNA”) do not provide investment advice and no action should be taken or omitted to be taken in reliance upon information in this document. Any opinions expressed may change. This document may include a list of clients. Please note that inclusion on this list should not be construed as an endorsement of EOS’ or HSNA’s services. EOS has its registered office at Sixth Floor, 150 Cheapside, London EC2V 6ET. HSNA’s principal office is at 1001 Liberty Avenue, Pittsburgh, PA 15222-3779. Telephone calls will be recorded for training and monitoring purposes. EOS001026 0013136 06/22.