SLAUGHTER AND MAY

Managing the Energy Transition “Mind the Gap”

Making the transition to a carbon neutral global economy is increasingly seen as a “must”. The oil and gas industry and wider energy sector have to embrace that and do more than they have done to date. But the transition cannot happen overnight. Cutting off investment in oil and gas before alternative sources of energy are ready to fill the gap could result in a massive supply crunch with serious consequences. And more needs to be done to reduce global demand for energy.

Mounting pressure and reduced investment

Oil and gas exploration and production companies are coming under mounting pressure from climate change activists and investors. Recent developments have included:

- protests and demonstrations at company headquarters and operational sites;
- legal claims being brought against oil majors in relation to climate change;
- concerted action from investor groups demanding greater transparency and a commitment to adopt climate change goals; and
- moves by some institutional investors to stop investment in fossil fuel companies, particularly those that are not doing enough to acknowledge and address the climate change challenge.

Oil and gas companies have to accept the new reality and play their part in making the Energy Transition work. But the outflow of capital from the sector is a cause of concern. The sale of existing interests and reduced appetite for new investment in the sector means companies are likely to find it harder to raise the capital required to develop new oil and gas projects. In an industry where continued new investment is needed to offset the natural decline in production from existing fields, there could be a marked reduction in supply in the coming years if the trend to reduce investment in the sector continues.

Supply crunch

That would be fine if supply of energy from more sustainable sources such as renewable energy was able to grow fast enough. Whilst some countries have made good progress in reducing Greenhouse Gas (GHG) emissions, that has so far been driven as much by a shift from coal to gas as a greener alternative, as it has from a move to renewable energy. And the reality is that demand for oil and gas is still forecasted to increase over the coming decades as global demand for energy continues to outpace the growth in generation from sustainable energy sources. So unless there is a radical reduction in global demand for energy, it seems likely that oil and gas production will continue to have an important part to play in energy supply for some time to come.

Which brings us back to investment. New investment will not be possible if companies are starved of capital, and a sustained withdrawal of capital from the sector will inevitably result in a significant reduction in production over the medium and longer term. This could result in a supply deficit on an unprecedented scale, which would almost certainly result in a significant spike in oil and gas prices with a major impact on the global economy.

A much broader solution is required

There is more that energy companies could be doing to reduce their own GHG emissions; demonstrate a clearer commitment to Energy Transition; and work with consumers of energy to encourage them to use less energy. But there is a limit to what energy companies can achieve on their own. If the world is going to become carbon neutral and reduce its reliance on fossil fuels, there needs to be a much more fundamental change on the demand side of the equation. Put simply, we all need to use less energy. Governments have used subsidies and tax regimes to stimulate growth in renewable energy generation and encourage Energy Transition, but not enough has been done yet to reduce (or at least stop the growth in) demand for energy. Unless industrial, commercial and domestic users of energy change their habits, there will come a time when governments will need to become much more interventionist and take concerted action to limit the amount of energy we all use.

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