

**The SPE-GCS Podcast “ESG impact on the industry” Transcript
Bob Brackett – 07/13/2021**

Marty Stetzer: Hi everyone and welcome. I'm Marty Stetzer, President of [EKT Interactive](#) in Houston. We're proud to be the podcast sponsor for the Society of Petroleum Engineers, Gulf Coast Section. The section was founded in 1935 and now has over 11,000 members. It is a volunteer organization that provides member forums to upgrade and maintain professional competency. This podcast is part of our series, and another learning resource available to the members. Numerous on-demand webinars can be accessed at www.spegcs.org.

Today our topic is Environmental Social Governance or ESG, and why we in the industry should pay attention to this concept. Today I'll be speaking with Mr. Bob Brackett, Senior Vice President, covering global metals and mining and North American oil and gas at AllianceBernstein. Previously, Bob had leadership positions at both Hess and ExxonMobil, so he really knows the industry.

We're happy to have his input on this topic as it becomes more important to oil and gas. Bob, thanks so much for speaking with us today.

Bob Brackett: It's my pleasure, Marty. Thanks.

Marty Stetzer: Can we start off with your definition of ESG, how it differs from sustainability, and why SPE members should follow this topic?

Bob Brackett: Happy to, and I'll talk about ESG first. And you can be cynical about things such as ESG, and you can think, oh, is this just social responsible investing? Is this Myers-Briggs? Is this four hats? Is this just another management fad? And so what I'd like to hopefully demonstrate is, it's actually just part of the business. It's just a different way of thinking of it.

And in a sense, the oil and gas business or any business is a series of relationships. I'm worried about my customer, what price can they pay for my goods or services – for a barrel of oil in our case. I'm worried about my supplier. How much can I get the service company to come out to the well site for? And so those are very obvious relationships.

I'm worried about my competitors. I have a relationship with them where, how do I make sure that I'm offering a better product or service, or extracting that incremental barrel at a better margin?

So, lots and lots of relationships. And so you should just think about ESG as three more relationships. And often they're not in that linear plane of how we think about the business. And E's the obvious one, it's the environment.

And the simple example of something like that is... if I own a bar and I'm out there playing loud music with folks hanging outside my bar late into the night, I'm basically imposing an externality onto my neighborhood. People in neighborhoods see the lights and the noise and they don't like it. If I run a butcher shop and I'm throwing my waste out the back door into the stream, I'm imposing an externality.

And the oil and gas industry, through what we do, extracting hydrocarbons and then ultimately combusting them to grow the economy and putting that CO₂ into the atmosphere, that's an externality. And so I've got to think about my business in relation to that externality.

And it's not just the environment. In terms of CO₂, it can be groundwater, it can be methane. It can be whatever my footprint is on the environment in which I operate. And I have to share that environment with others. So I've got a natural relationship.

The S is that relationship I have with the people inside my organization. If you can imagine a tyrannical CEO that doesn't care about the people that work for him, clearly there's a relationship there. And clearly in the same way, if I ignore the environment, I'm going to pay a price for it down the road. If I'm ignoring my organization, the folks in my organization, I'm going to pay for it down the road. So the

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most obvious one, under the S, is just health and safety. And that's something I would argue our industry does a pretty good job on.

The final letter is G which is governance. And in a way that's unique to being a publicly traded company. So a company that's on the stock market, a publicly traded company, doesn't have a single boss. It's got all of us potentially as bosses. There's hundreds of millions of shares of an ExxonMobil or BP or Schlumberger or pick your favorite company. And so there's a bunch of folks that own a tiny fraction of that.

And as a result, we assign a CEO and a management team to run that business. And so there's a relationship. That CEO, again, should not be tyrannical and ignore those small shareholders. He or she should act in the best interest of those. So that's that kind of final relationship. So that's all ESG is. It's just pausing and saying, I know how to run my business. Let's make sure I'm drawing lines between all of the key relationships.

Marty Stetzer: How does it differ from sustainability?

Bob Brackett: That probably comes, think about the E in ESG... and the E in ESG for our industry it comes back to emissions, CO₂ emissions into the atmosphere. And so when you think about CO₂ emissions from the E side, it's like, how do I minimize that? How do I worry about that long-term risk that those emissions will be taxed or priced?

On the sustainability side, what sustainability is; “am I going to be in business in two decades, three decades, indefinitely?” And so part of sustainability is internally focused. Am I good enough at exploring or obtaining resources that I can convert reserves to production, so that I'm constantly in business. We are a depletions-based business.

So by definition, every barrel we sell out the front door, we got to find a way to bring it in the back door, or we're not sustainable. So that's kind of internal sustainability. But the external sustainability is, will people want my product in 20, 30, 40 years? And to the extent that that answer is no, that's how those conversations go, and why would people not want hydrocarbons in 20, 30, 40 years? Well, because folks think that we're transitioning the global economy from a hydrocarbon-intensive energy industry to less intensive. So that's the sustainability risk as we think out multiple decades.

Marty Stetzer: Thanks Bob. In your opinion – there's so much written about it in the press – what does ESG mean for Wall Street... and how does Wall Street influence what the oil and gas companies do?

Bob Brackett: Yeah. And ESG, the way to think about Wall Street and the way to think, my job as part of Wall Street, is researching and developing investment ideas to help large institutional investors make money. They're acting on behalf of their clients and then that money moves on to them.

And so within Wall Street, almost... there is a battle you might say between two styles of investing. And the first style is active investing. And the second is passive investing. Or said another way the first is humans at the wheel, and the second is robots at the wheel. And what I mean by that, passive investing is... there's plentiful ways that you can go onto your investing operator, investing website, and you can purchase ETFs, electronically traded funds. And what those are, are effectively algorithms picking a basket of stocks to reflect your investment needs.

And those algorithms don't need to eat. They don't need to send their kids to private school. They don't need to rub shoulders. And so therefore they come at a much lower cost structure. And so over time, passive management has been taking share from active management, where active managers are humans spending all of their time dedicated to this task.

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However, there are some things that passive management doesn't do as well, and that's where ESG comes in. And so ESG, number one, it's very important to large investors. And that means they're willing to pay greater fees in order to own stocks that are both going to outperform and have the right ESG characteristics. So they're willing to pay higher fees and frankly it takes more work. Humans are better at actively managing between ESG investing and whatnot. So it's a natural place. And as a result, it's a part of Wall Street that's been growing in terms of assets under management, the capital flowing into the sector.

And so that's why the humans on Wall Street are focused on ESG. It's a new form of business, it appeals to their skill set, and they can charge a little more for it. So that's why it's important to Wall Street. Now, what Wall Street then does, is make sure that they can influence the strategies of oil and gas companies.

Great example in the mining side... This time last year there was an incident in which an Australian iron ore miner destroyed a cave that was a heritage site for Aboriginal people of Western Australia. A relatively small cave that doesn't show up in the financials of the company. There was no huge billion-dollar fine or much of anything. But the Chairman, CEO and Head of iron ore – all lost their jobs. And they lost their jobs because Wall Street, the shareholders, looked and said, this is unacceptable and it's going to impact our ability to recommend you as a company. So let's fix it.

So clearly that level of influence can start at the very top and percolate through. The other way it percolates through for oil and gas companies is Wall Street is telling oil and gas companies not to grow. They're saying, stop flooding the market with production from the Permian, Eagle Ford, Bakken, and instead stop growing. Take all that cash that's coming out of those wells and just give it back to us. And what that influences is not the CEO necessarily, but it certainly influences us, the petrotechnical professionals all through the food chain, if the level of activity is falling.

Marty Stetzer: Bob, does that mean that over time the high costs, long lead time, hundreds of millions of dollars of projects in either the offshore or let's say oil and LNG gasification, are going to dwindle?

Bob Brackett: So the one example would be company called Cosmos Energy that about a year ago, looked and did a very thorough sustainability study... and what they said is – they're deep water explorers – and they said, if we go out and explore for deep water oil, it might take us a decade. And then we're going to praise that discovery and move it to development. That might take us another decade. I'm rounding up, but that's the idea. And then suddenly 20 years from now, this beautiful oil system starts producing. It might take us another decade to recoup all of our capital and earn a return. And then you look and say, well, 30 years from now is 2050.

That seems like an awfully far time away in a world where technology seems to reinvent the planet every 5 or 10 years. And so maybe we're not going to do that. That time horizon puts those investments at risk. So let's focus on different things, right? Gas, for example... LNG, which might have a much longer future or shorter cycle projects. So that is kind of the debate in the sector.

Another example would be the European integrated oil companies transitioning to renewable energy, wind power, et cetera. So we're very much in a world where people are afraid of putting, frankly, billions of dollars of capital to work, into a pretty uncertain future.

Marty Stetzer: You mentioned the miners earlier, and you told me when we were planning our podcast, that they had already tackled ESG. How did they do it? Were they successful? And are there some lessons learned for oil and gas?

Bob Brackett: Yeah. And so I think there are... the sectors are very similar. In a sense, the way they did that and I could belabor it, but there are really two ways. So first, coming out of 2016 – we all remember

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2016 is the bottom of our last cycle. We had another one in 2020, but in 2016 was also the bottom of the cycle for the metals and mining sector.

And coming out of that cycle, the industry decided not to chase volume growth. They said, what we're going to do is focus on keeping volume flat, maybe grow it a few percent - and not contribute to the problem. The classic phrase is “The cure for low oil price is low oil price, and the cure for high oil price is high oil price.” Typically as price rises, too much capital flows in and creates the next cycle.

So the miners basically transitioned and said, if investors want cash back, we'll give them back and we're not just going to take a hundred percent of the cash coming out of our wells – in their case, their mines – and put it back into more supply. So that's one way they solved the problem in the short run, is they appealed to what investors were after.

The way they kind of solve the problem in the longer run was to be part of the solution. So if you think about transitioning from gasoline internal combustion engine to electric vehicles, electric vehicles take a lot of copper. They take a lot of lithium or nickel, cobalt, manganese. And so offshore wind takes rare earth elements, and solar farms take silver, and fuel cells take platinum. And so the miners are looking and saying, what are the raw materials that the energy transition needs? And let me go chase those because there could be a big market coming there.

Marty Stetzer: So back to oil and gas, what could an ESG-heavy future look like for our industry? And earlier you mentioned returns to shareholders. Haven't a lot of the major oil companies been doing stock buybacks and kind of maintaining dividends for quite a few years? Is this going to change their strategy?

Bob Brackett: Yeah. And so if you think about the ESG future, it really is the E is the important part., The G in oil and gas, we've certainly made our mistakes and we've not always been shareholder friendly. The S, in the distant past we've had issues, but certainly on the health and safety side, statistics on our industry are much safer than... pick the taxi and limousine industry, the forestry industry, law enforcement. Given the amount of steel we move around at high speed and high mass, we're a very safe industry.

So it's really the E, which is what can we do in terms of CO₂ emissions? And, one is... ultimately just to unlock creativity. And so I'll talk about two ways. So first I'll talk about what the cynic or the pessimist would say.

And they would say our industry is a dinosaur, where a stranded asset, demand for oil is going to fall and go away and be replaced in natural gas by other things. And so we're in our twilight and let's give up. So, number one, that's not true. That's not how twilights work. And number two, there's a dawn after the dark.

So, in terms of the twilight, if I told you that the mercury industry, again, back to kind of metals and mining – because there's lots of interesting lessons – the mercury industry has never earned more money than it is today. I've got a hundred years of data for the mercury industry. You might say, well, that's insane. Mercury is about the worst thing you can imagine. If you're my age, you remember having mercury thermometers in school and the panic if one broke and spilled. Mercury, it's toxic, it drives you insane. It's bad for your health.

And the world is trying to get rid of as much mercury demand as they can. And as a result, the demand for mercury falls maybe 3% a year. So here's something that's deadly and we can't seem to get rid of it on the demand side.

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On the supply side, you would have to be a fool to go out and invest in a new mercury mine. And so, as a result, the mercury industry is afraid to put capital to work in all but the shortest cycle, really fast profitable projects. And so every year we wake up and there's still some demand for mercury, but the supply side says, guys, I can't.

And so similar with asbestos, we could make the same point. And the asbestos industry is at a hundred year high in terms of revenues. And so what people don't understand for depletions-based businesses like ours, for extractive commodity industries like ours, is there is a ton of capital just to keep supply from falling 15%.

And so, because what we've done is we've put incredibly high hurdles to earn a return. And the way we'd say it in economics is we put really high discount rates against allocating capital. And so every year we're going to wake up and say, I'm afraid to go put that 5-, 10-year, 15-year payback project together so let me stick to a shorter cycle and let me drill a few more shale wells, et cetera.

So don't expect as demand for oil peaks, plateaus, and rolls... the day that happens, it doesn't really have some catastrophic impact on price because the supply side is so much more levered. Our success depends on price. We're much stricter about capital than the demand side, which says, well, give me a few more barrels. So that's... don't worry about the business as usual. It's going to be around for an extremely long time.

Then the positive side is – all we need is a price for carbon. Effectively, it's not enough; it is necessary but not sufficient for us to emit less CO₂ to add to the reservoir in the atmosphere. We're going to have to move to negative emissions technologies. And to do that, both to defer or destroy demand for hydrocarbons, and to incentivize us putting them away – negative emissions technologies – there needs to be a price for carbon. That price has to be fairly significant by all estimates, whether you're the IEA or the UN.

And the problem is it's just not a very visible price today. And so I know what the price of Henry Hub is. I know what the price of WTI or Brent is, and I can at least get a sense of where they're going and I can put lots of money against that product price.

Someday there'll be a price for carbon. Someday we're going to reverse the polarity of our business. We're going to take CO₂ from a point source, move it through a midstream investment, find a pad, drill a well, have a geologist tell us where to put it, have a production engineer inject it, have a reservoir engineer monitor that. And so we're literally going to do every business aspect that we do today, but sort of like in reverse.

There's an old expression about Fred Astaire I can't quite remember... but we're basically going to do our same dance backwards, and unlock a host of technologies and innovations around that. We just need a price from carbon to get there. So that's the hope that we're going to be part of the solution. And in the same way, if you give us a price signal for shale gas, we can flood the market with more than we ever thought. Give us a price for CO₂ and we'll get rid of more of it than you could have contemplated.

Marty Stetzer: Bob, with that perspective on the industry, is there a role that SPE members can play as we go forward?

Bob Brackett: Yeah. I mean, that's effectively, one is... just one of optimism. The cycles are tough. And this last year has been a terrible cycle. None of the cycles are easy, but don't let the cycle completely wear you down. So the answer is keep doing what you're doing. Don't let pessimism, don't let sort of the negative sentiment against our sector wear you down.

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And keep working on those same technical skills, because you're going to use them twice. You're going to use them for the next 50 years to help folks build an economy off of energy, which we've been doing for the last hundred. And then part of that time, you're going to flip it and do it in reverse and start to sequester that CO₂.

Marty Stetzer: Bob, that was awesome. Especially your analogies from the metals and call them other depletion industries. Thanks so much for your time and insights on this new and very important topic. They will definitely be valuable to not only the SPE GCS audience, but our own community of 10,000 [EKT Interactive](#) listeners.

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Thanks again.