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ESG: What You Need to Know Now

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Haynes and Boone, LLP

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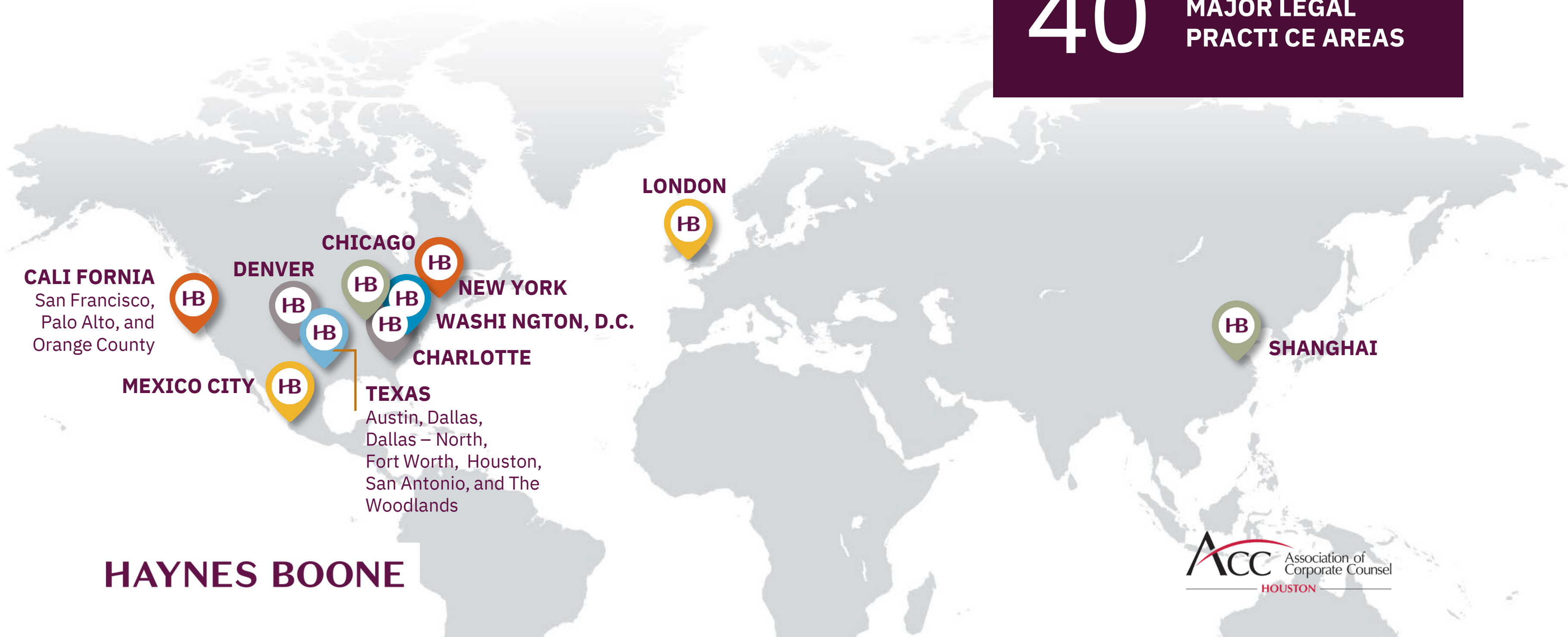

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What is ESG?

Environmental, Social, and Governance (ESG) - criteria comprise a set of standards for a company's operations that socially conscious investors use to screen potential investments

Environmental	Social	Governance
• Climate change and greenhouse gas (GHG) emissions • Energy efficiency • Resource depletion, including water • Hazardous waste • Air and water pollution • Deforestation	• Human rights • Workings conditions, including slavery and child labor • Local and indigenous communities • Conflict with community goals • Health and safety • Employee diversity	• Executive pay • Bribery and corruption • Tax strategy • Transparency • Shareholder rights • Donations • Diversity and structure

Many Stakeholders are Focused on ESG

- Investors
- Employees
- Suppliers
- Customers
- Non-Governmental Organizations (NGOs)
- Lenders
- Insurers
- Media
- Communities

Given the Spotlight on ESG—What Risks Do Companies Face Today if They are Behind on ESG?

- Cost and availability of capital
- Activism
- Risks associated with electing board—for example, State Street intends to vote against directors of companies who are behind their peers on ESG
- Litigation
- Regulatory enforcement

What are the Benefits of Developing an ESG Strategy?

- It’s not all about just “doing good deeds”
- Incorporating ESG into the long-term business strategy can help a company develop new business opportunities and increase sales, productivity and employee satisfaction while reducing energy demands and expenses, as well as increase good will
- The process also helps companies identify and manage business risks related to ESG:
  - Reputation Risk
  - Physical Risk
  - Regulatory Risk
  - Transition Risk

For Public Companies - What Can Go Wrong by Disclosing ESG Goals and Achievements?

- **Potential consequences of misleading disclosure**
  - SEC enforcement actions
  - Private litigation
- **Before you make ESG disclosures**

  “Stop, look and listen”
  - Is the company “guaranteeing” certain ESG goals in public statements?
  - What standards is the company using for disclosing metrics?
  - Is the company sufficiently tracking relevant information to report ESG metrics?
  - Are there sufficient disclosure controls in place to ensure timely reporting of ESG-related information?

Haynes Boone and EnerCom Oil & Gas ESG Tracker

General Trends

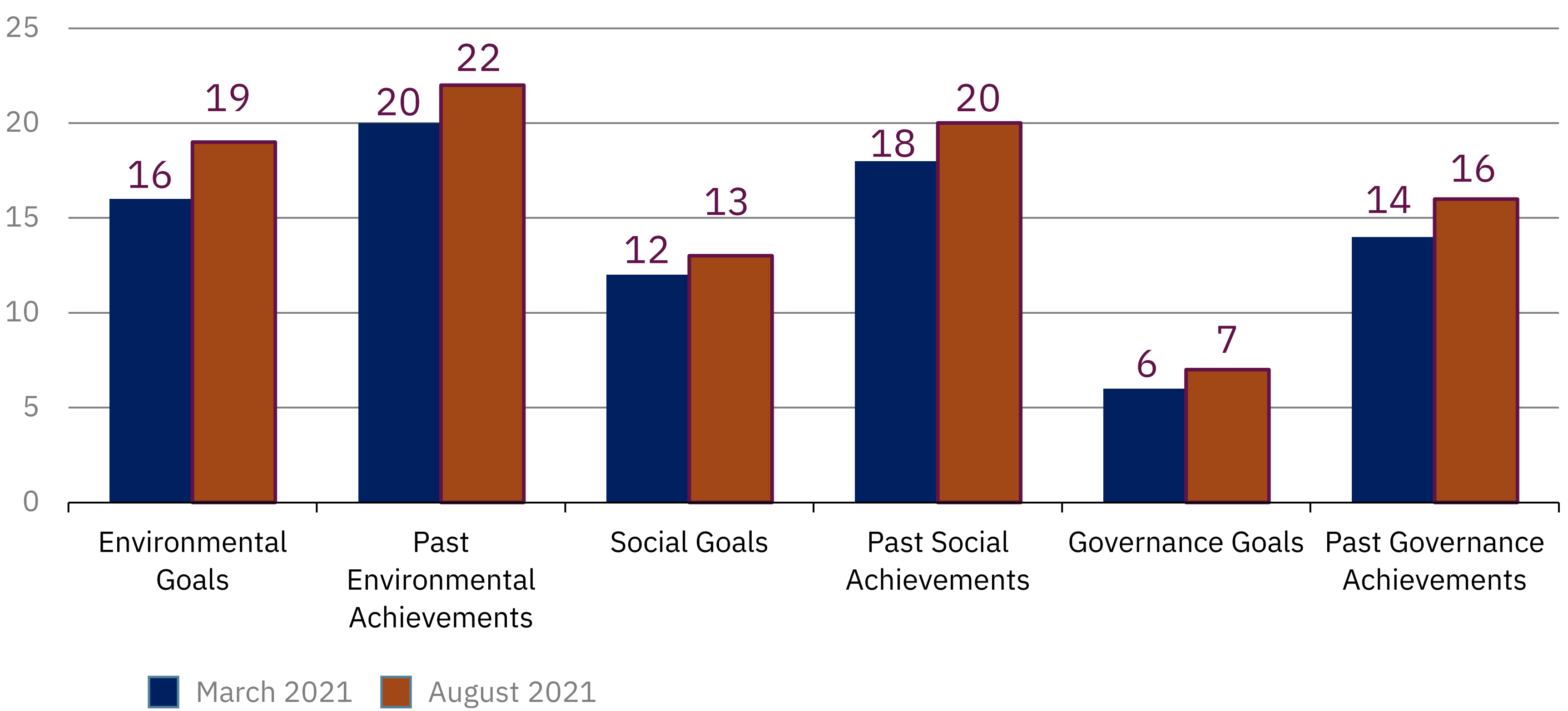
1. ESG has been widely adopted.
2. Most oil and gas companies have announced and implemented comprehensive ESG programs.
3. More companies are disclosing GHG emissions and reporting emissions reductions.
4. Companies with goals of "Net Zero" carbon emissions by 2025 grew by 150% since March.
5. Companies are reporting more ESG achievements and announcing more goals for each ESG criterium.

Proxy Statement Disclosure Trends

1. Companies are increasingly addressing ESG goals and strategy in the proxy statement.
2. Companies are disclosing more quantitative metrics, demonstrating progress toward implementing ESG goals.
3. Companies are disclosing details of stockholder engagement efforts relating to ESG.
4. More companies are forming ESG Committees and identifying directors with ESG-related skills.
5. Companies are incorporating ESG metrics into performance targets.

Analysis of the Sample Producers

Does the sample producer report ESG strategies, goals or previous achievements?



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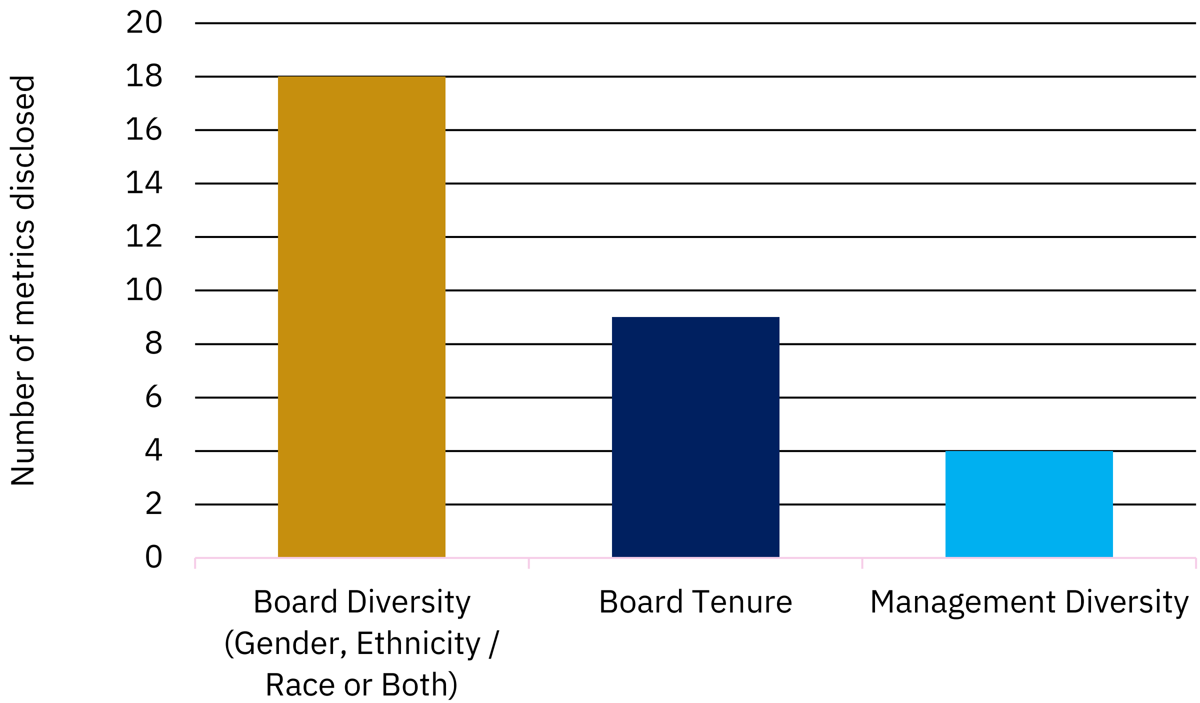
Proxy Statement Disclosures

- Significant growth in ESG disclosures in proxy statements.
- Companies have begun including ESG disclosures in earnings releases, major announcements and other press releases.
- The expansion of ESG disclosures is evidence that investors and other stakeholders continue to push for more disclosure.
- However, companies must balance the demand for disclosure with potential liability based on ESG disclosures.
- Given the formation of the Climate Change Task Force and SEC commentary in 2021, we expect to see SEC enforcement activity relating to ESG disclosures.
- Companies should focus carefully on the process of tracking, vetting and reporting ESG disclosures to mitigate potential liability.

Proxy Statement Disclosure Trend
Companies are providing more Governance disclosures

Governance quantitative metrics disclosed

Fourteen sample producers disclosed an aggregate of 31 governance quantitative metrics. The most common metrics disclosed were related to board diversity and board tenure.



Sample disclosures:

- "X% of our directors are female."
- "X% of our directors are ethnically or racially diverse."
- "The average tenure of our directors is X years."

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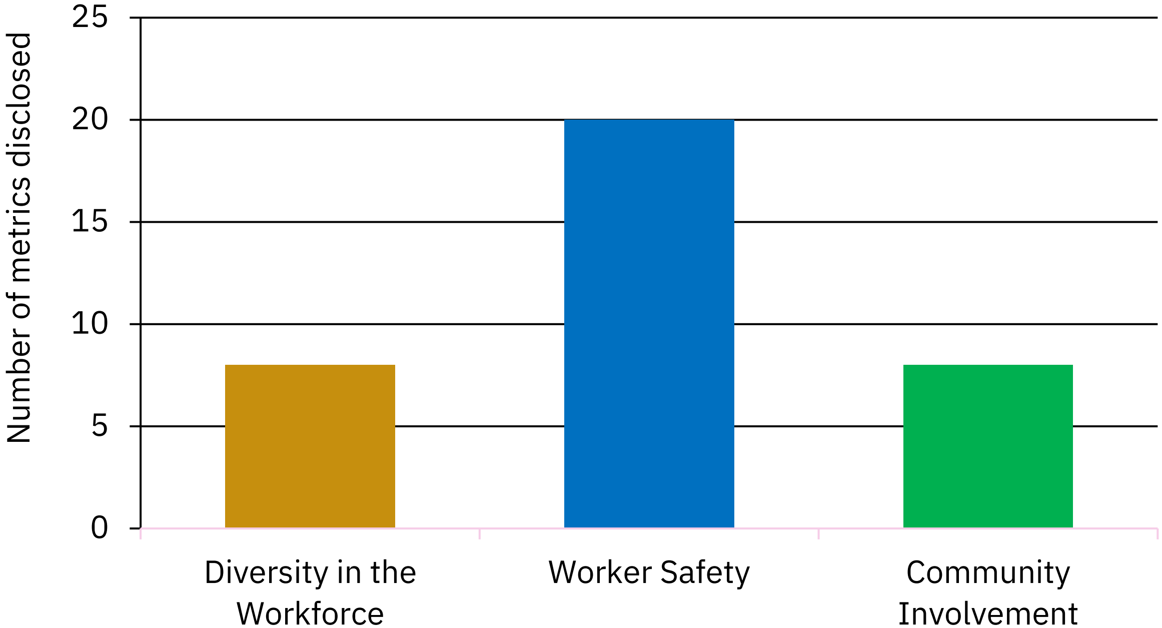
Proxy Statement Disclosure Trend
Companies are providing more Social disclosures

Social quantitative metrics disclosed

Fourteen producers disclosed an aggregate of 37 quantitative metrics in the “Social” category. The most common were worker safety, diversity in the workforce and community involvement. These metrics reflect the current focus on diversity as well as safety, especially during the COVID-19 pandemic.



Sample disclosures:

- “X% of our workforce is ethnically or racially diverse.”
- “Our lost time incident rate in 2020 was X.”
- “We donated $X to a charity.”
- “We logged X hours in worker safety training in 2020.”

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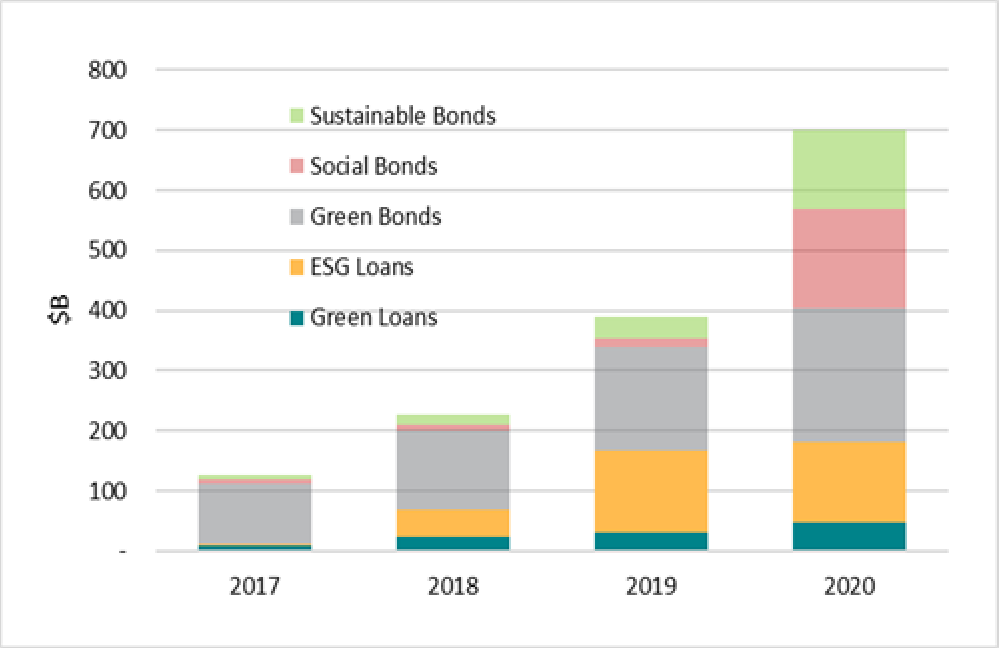
ESG/Green Lending

2020 Global Green & ESG lending jumps 80% to US$701B



Source: Refinitiv LPC, an LSEG Business

ESG and Finance

Green/ESG Finance

- Loans made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible ESG Projects.

Sustainability Linked Loans

- Loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit) which provide for preferred pricing on fees, interest or margin upon the borrower meeting certain ambitious ESG performance targets in its own operations. Use of loan proceeds is not relevant to the determination as to whether the Borrower has achieved compliance.

Sustainability Linked Loans: SLLP Guidance

Sustainability Linked Loan Principles Guidance from the LSTA

1. Selection of Key Performance Indicators
   - Evaluation of Borrower's sustainability goals and current progress
   - Transparency of current objectives and progress
   - Disclosure of internal standards, certifications or targets
2. Negotiation of Sustainability Performance Targets
   - Consideration of factors most impacting Borrower's business and operations
   - Typically bespoke
   - Aspirational, ambitious and meaningful
   - May be tied to current ESG Disclosures
3. Borrower must report progress
4. Lender needs to be able to track and/or verify progress
   - External verification required where information is not publicly available and/or easily verifiable

Examples of KPIs and Green Loan Purposes

KPIs

- Percent reduction in overall Greenhouse Gas Emissions in operations
- Reduction in emissions in targeted part of operations
- Number or percentage of female and minority board members or executives
- Minimum standards on recruiting processes
- Percent increase in services offered to underserved communities
    - Internet
    - Access to healthcare
    - Green space
    - Public transportation

Green Loans

- Renewable energy projects
- Sustainable construction
    - Energy efficiency
        - Insulation, heating and cooling systems
        - Power conserving windows
    - Water conservation
    - Development of renewable energy for commercial and residential projects
- Community focused projects
    - Public Transportation
    - Green Space
    - Resource conservation or reallocation

PERSPECTIVE ON ESG FROM CLIENTS

- ESG investing is not new, it is a 20+ year movement that has recently gained significant traction
- What has changed recently?
  - Ability to earn competitive returns on cleantech investments
  - Pandemic
  - Growing concerns on climate change
  - Political changes, increased regulation and enforcement of policies
- "E" Transition Well Underway
  - Massive capital formation around ESG theme over past 12-18 months
  - Investors want to do good and make money – now both are possible
  - Many large investors/LPs are political animals, stating ESG issues are important and looking to deploy capital around it
- "G" and "S" are likely to receive increasing focus in the coming years

FINANCIAL SPONSOR & INVESTOR PERSPECTIVE

ESG as an Investment Thesis

- Massive amount of capital lined up for ESG investment (especially cleantech)
  - Everyone trying to find the next big thing: LNG, EV fleet transition, solar, distributed solar, wind, batteries, bringing power sources closer to end users
  - Squeezing of profit margins and returns
  - SPAC activity
- Greenwashing
  - Proliferation and non-standardization of ESG ratings: 100+ organizations producing sustainability research and ratings
  - Investors are confused and largely ignore most rating systems
    - Deselecting entire industries and/or looking for leaders in certain industries
    - Invest on what they think is ESG compliant
  - Jury still out on whether “ESG” funds have outperformed, or how much of it is driven by Tech and other sectors
  - SEC has started to target private funds

ESG Impact on Day-to-Day Operations

- Financial sponsors are paying attention to ESG
  - Asking more questions around ESG in due diligence
  - Hiring consultants to do portfolio views and help with reporting
  - Providing ESG metrics to LPs
  - Preparing for exits and anticipating more questions around ESG

PUBLIC COMPANY PERSPECTIVE

- Oil & Gas migration to cleantech largely driven by investors
- ESG activism impact on public companies:
  - Not necessarily resulting in reduction in oil and gas production and use
  - Clients are looking to at opportunities to acquire low-ESG scoring businesses at a discount
  - Ownership of oil and gas assets may move into private and state-owned hands
  - Companies have stepped up their game
    - The ESG bar is rising and companies need to stay ahead of peers
- Concern activist initiatives will migrate from “E”-focused to “S” & “G”-focused
- Companies consulting with select ESG ratings agencies to tailor disclosure and actions they will take
- Movement to standardize ESG ratings similar to how financial reporting standards are regulated by IASB

INCREASING FOCUS ON "G" AND "S"?

Governance

- To provide proper oversight, all members of board of directors need to familiar with ESG issues, not just appointing a "climate expert"
- Diversity of boards & cybersecurity expected to be increasingly scrutinized

Social

- 2020 saw social justice and health care move to the forefront
- Workforce issues, the "new normal", remote work flexibility, mental health
- Carbon impact on minority communities

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