Big Oil's green dream has turned into a multibillion-dollar nightmare

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Body

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Last week BP announced that it had sold its offshore wind assets into a joint venture with Japan's JERA, itself a joint venture between Tokyo Electric Power and Chubu Electric Power, to create one of the world's largest offshore wind businesses.

That followed an earlier BP announcement, in September, that it planned to sell its US onshore wind farms.

Under former chief executive, Bernard Looney, BP had been building its wind farm portfolio as part of an ambitious strategy to cut its hydrocarbon production by 40 per cent by 2030, reduce its emissions and those of its customers by 35 to 40 per cent by the end of this decade and become a "net zero"-emissions company by 2050.

Last year it started backing away from those commitments, saying it would cut production by only 25 per cent by 2030 and its emissions by 20 to 30 per cent.

This year, under a new chief executive, Murray Auchincloss, it now appears even those reduced targets are being wound back.

It's not just BP.

Shell has scaled back its investment in renewables, including offshore wind and hydrogen; it has reduced its emissions' intensity targets and it has abandoned its objective of becoming the world's largest electricity company. Norway's energy giant, Equinor, has also announced plans to shrink its renewable energy division.

As they retreat from their push into renewable energy and downgrade their ambitions to build major exposures to electricity generation, the UK and European ***oil*** companies are refocusing on their traditional ***oil*** and ***gas*** businesses.

Where previously they planned to cap or reduce their production, now they are planning and investing to increase it.

Last year BP raised its forecast of ***oil*** equivalent production from 1.5 billion barrels a day by 2030 to 2 million barrels a day, planning to invest $US8 billion ($12.6 billion) more than previously budgeted on new ***oil*** and ***gas*** investments. Since Auchincloss became CEO, that focus on lifting hydrocarbon production has intensified.

The commercial logic in what they are doing is clear. BP generates returns of 15 to 20 per cent on its fossil ***fuel*** investments but only 6 to 8 per cent from its renewable assets, with wind's returns inferior to solar's.

Ploughing billions each year into wind, solar and hydrogen dilutes the overall returns on capital and reduces the returns to shareholders, making them most unhappy. Having invested about $US18 billion over the past five years in lower-returning renewables between them, BP and ***Shell*** investors have become increasingly unhappy.

Moreover, the UK and European energy majors are always compared with their US counterparts.

Exxon and Chevron haven't been anywhere near as committed to lowering the carbon intensity of their portfolios as their transatlantic rivals. The US majors were committed to the "drill, baby, drill" mantra before Donald Trump and saw that reflected in their share price relativities with their UK and European counterparts.

Where, over the past five years, Exxon's share price has risen 54 per cent and Chevron's 23 per cent, BP's has fallen 22 per cent and ***Shell***'s more than 6 per cent. That kind of disparity in performance tends to galvanise shareholders, along with executives motivated by their remuneration.

By moving its offshore wind assets into a joint venture vehicle and off its own balance sheet BP will keep an exposure to wind but significantly reduce the amounts of capital devoted to it and the levels of debt supporting it.

Between them, BP and JERA plan to spend up to $US5.8 billion on their combined portfolios (which includes the proposed Blue Mackerel offshore wind farm in Bass Strait) by the end of 2030. With shared investment and non-recourse funding, BP's capital commitment will be modest relative to what it would otherwise have been.

Both BP and ***Shell*** still seem committed to solar, which is less capital intensive than wind, but that won't help them escape the criticism from climate activist groups and ESG (environmental, social and governance) investors, who are particularly vocal and litigious in Europe and the UK.

The problem, of course, is that the companies can't satisfy both constituencies and in a contest between emissions and returns is one that ultimately shareholders will always win.

With Trump about to return to the White House and *open up US federal lands* to more drilling for ***oil*** and ***gas***, and the incoming Treasury Secretary, Scott Bessent, having a "3-3-3" plan that includes lifting US energy production by three million barrels of ***oil*** equivalent a day, the contrast between the environment for the US producers and their competitors elsewhere will only become starker and the pressure from shareholders on companies like BP and ***Shell*** will only intensify.

Trump also plans to remove the generous 10-year tax credits for renewables within Joe Biden's Inflation Reduction Act, which, if he is successful, would make the returns from investment in US renewables even less competitive with those from fossil fuels.

Any increase in US ***oil*** production would add to the existing glut in the ***oil*** market and depress prices that are already under pressure, despite the withdrawal of about six million barrels a day of supply by the OPEC+ cartel.

The lower prices being experienced now and likely to continue into at least the first half of next year, however, aren't an argument for the ***oil*** majors to invest in renewables.

Returns from ***oil*** and ***gas*** will still be superior to those from renewables and, if ***oil*** and ***gas*** prices and profits are under pressure, there will be even more of an incentive to invest only in the highest-returning assets.

Those who invest purely in renewables appear unconcerned about the gradual withdrawal of the ***oil*** majors who gatecrashed their sector and, seeking to gain scale rapidly, drove up the costs of developing greenfields projects.

Ploughing billions each year into wind, solar and hydrogen dilutes the overall returns on capital and reduces the returns to shareholders, making them most unhappy.

There are a lot of environmentally-sensitive and patient investment funds available from sources other than the ***oil*** majors that are willing to trade off returns for their convictions and/or consistent long-term returns, so losing some investment from the ***oil*** companies shouldn't retard renewables developments.

It was always going to be difficult for BP and ***Shell*** to try to produce a balance of their traditional ***oil*** and ***gas*** businesses and renewable energy portfolios while satisfying both financially-motivated and ESG-driven investors.

It has been particularly difficult for the UK and Europeans, with their lower returns but better environmental credentials, to attract investors in the US. There's been a backlash against ESG investing in the US where, because there is no significant stigma associated with the ***oil*** and ***gas*** industry, valuation metrics tend to be higher.

If BP and ***Shell*** want better access to those more attractive metrics, improved share price performances and access to cheaper capital, they have no realistic option but to shed, and invest less in, low-returning assets. That's what they are now doing.

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