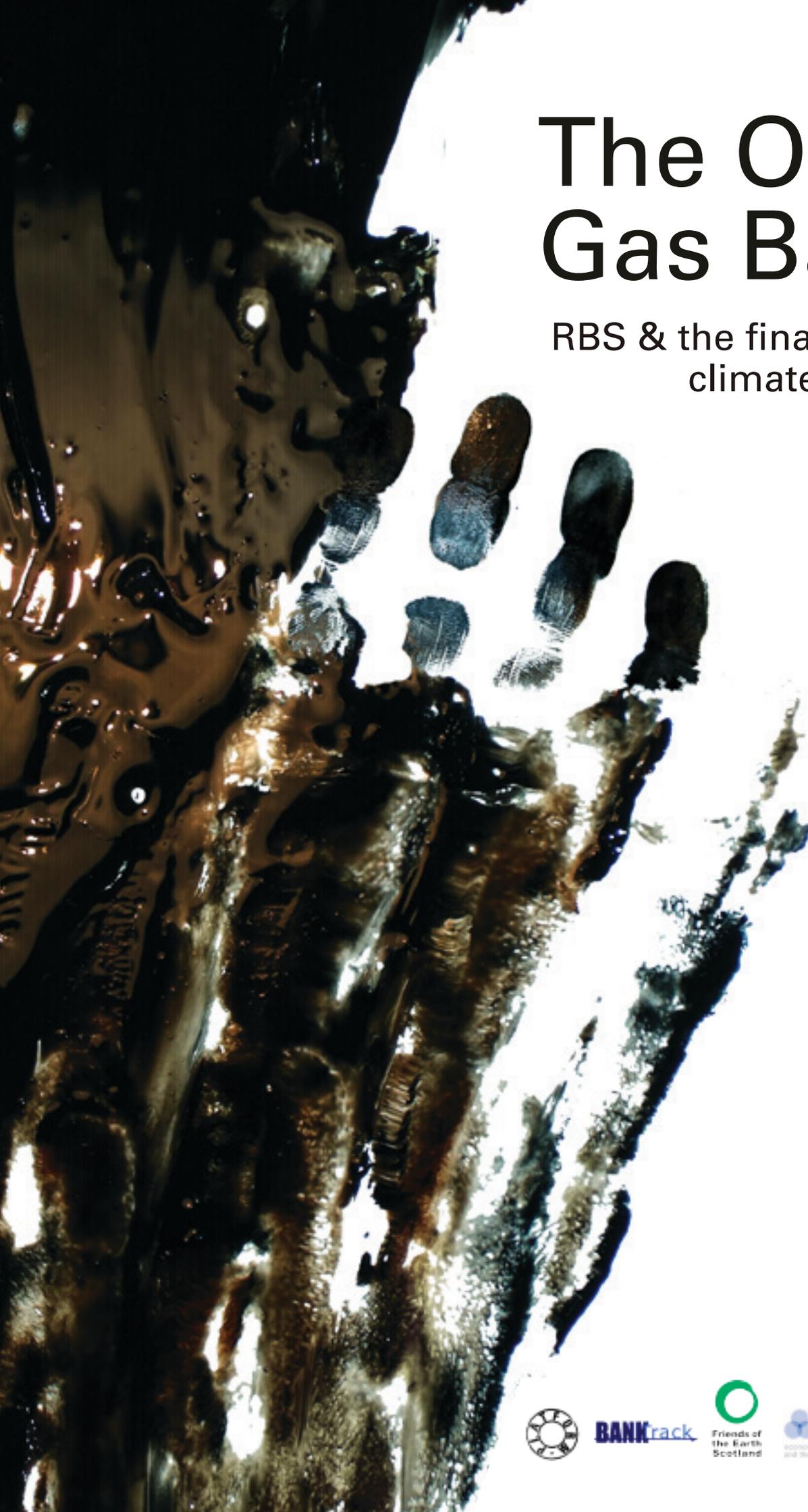


The Oil & Gas Bank

RBS & the financing of
climate change



BANKtrack



Friends of
the Earth
Scotland



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economics as if people
and the planet mattered

people & planet

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Executive Summary

The Royal Bank of Scotland is the primary UK bank financing new extraction of the fossil fuels whose use is accelerating the planet's atmosphere towards its climatic tipping point.

The second-largest bank in Europe, RBS has global assets of over \$1120bn including high street brands NatWest, Direct Line and Churchill Insurance. Despite creating a public image as a "good neighbour" through sponsorship of sports and the arts, RBS business activities have major destructive impacts on the environment and society.

Publicly identifying itself as "The Oil & Gas Bank", RBS provides oil corporations with the cash to build and operate drilling rigs, pipelines and oil tankers. From West Africa to the Ecuadorian rainforest, from the North Sea to the Middle East, RBS loans play a key role in forcing open the new carbon frontier, which contributes to environmental destruction, disruption of indigenous peoples and increased conflict across the planet.

The bank is contributing heavily to the acceleration of climate change. Less through energy used in RBS' buildings or business travel ("internal emissions"), but through the far larger "embedded carbon emissions" resulting from its financing of fossil fuels. If carbon dioxide molecules had corporate tags of responsibility, the atmosphere would be full of RBS logos mingling with those of BP, Exxon and Shell.

This report finds that

- The emissions embedded within RBS project finance to oil and gas projects reached 36.9 million tonnes in 2005, equivalent to those of 6.2 million homes - one quarter of UK households.
- Provisional figures for 2006 already show that RBS emissions were likely greater than Scotland's.
- The thirty oil and gas project finance deals signed between 2001 and 2006 locked in future emissions of 655 million tonnes over the next 15 years, more than equivalent to the UK's entire annual emissions.

These emissions are the result of financing major oil & gas extraction projects. For example, RBS was intimately involved in the financial arrangements for five major liquefied natural gas projects in Qatar. When consumed in heating, cooking or industry, the gas from these projects will cause 156.9 million tonnes of carbon emissions a year. If RBS goes ahead as lead arranger for Shell's controversial Sakhalin II project in Russia, the extracted fossil fuels will cause annual emissions of 60.9 million tonnes.

While competitors of RBS have begun to recognise their carbon responsibilities, RBS lags behind. Others have committed to reducing embedded emissions or accept that their "most significant impact [on climate change] is the investment and lending decisions [made]". In contrast, RBS has neither acknowledged its major impacts on the planet's climate, nor adopted a corporate finance policy on climate change. In December 2006, RBS launched its new website www.theoilandgasbank.com

RBS has financed a number of renewable energy projects, including wind farms in Italy and Australia. This is to be welcomed, but remains minor compared to its oil & gas focus.

The financing of new oil and gas projects is a root cause of climate chaos. To begin addressing its climate responsibilities, RBS must significantly reduce embedded carbon emissions and redress the imbalance of energy investments between fossil fuels and renewables. Transparency, reporting and a process to divest from climate-unfriendly loans must be included in a comprehensive climate change policy.

RBS were repeatedly offered a right of reply to this report, but did not respond to the offer.



Oil Spill in Niger Delta
Photo: Human Rights Watch

Introduction: The Oil & Gas Bank

*"The thing that makes us different is that we are a truly oil and gas bank."*¹

Peter Buchanan, Director, Oil and Gas Team, RBS

With global assets of over \$1120bn, the Royal Bank of Scotland is the second-largest private bank in Europe, and sixth in the world. High street brands include NatWest, RBS, Direct Line and Churchill Insurance. Since the NatWest takeover in 2000, RBS has grown rapidly through overseas retail acquisitions and expanding its Corporate Markets division. Despite creating a public image as a "good neighbour" through sponsorship of the Edinburgh Fringe and Rugby Six Nations, RBS business activities are contributing to climate change more than any other British bank.

At first glance, high street banks' impacts on climate change might look minor. Carbon emissions appear comparatively low, primarily caused by computer screens and business trips. Yet RBS' products are not only bank statements and analysts' reports; banks are providers of financial services including loans, investment, accounts. These services play a central role in the exploration, production and transportation of oil and gas. While "internal" emissions from the bank's own energy use are relatively low, the carbon emissions embedded within its financial products are staggering.

Since 2000, the Royal Bank of Scotland has positioned itself as "the oil and gas bank"², providing oil corporations with the cash to build and operate drilling rigs, pipelines and oil tankers. Working closely with everything from the world's biggest oil companies to start-up minnows, RBS structures the loan agreements and provides the credit facilities that make new oil and gas extraction possible. While the RBS head office lies just outside Edinburgh, the London-based Oil & Gas Team work out of 135 Bishopsgate, towering above Liverpool Street Station. It is from these offices that the team underwrites projects and operations from West Africa to the Amazon rainforest, from the North Sea to the Middle East.

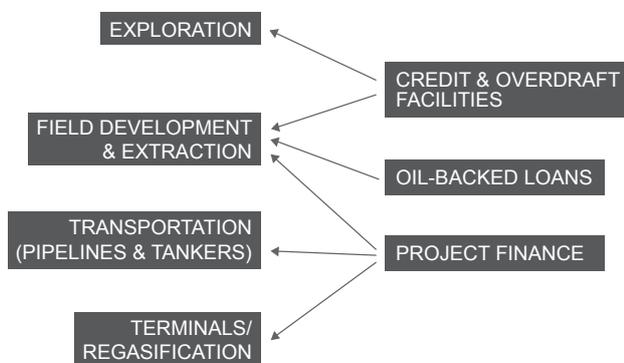
While all major banks are involved in financing the oil and gas industry to some extent, RBS has promoted its services more aggressively than most. Between 2001 and 2006, RBS provided over \$10 billion in oil and gas loans, and structured the loan agreements and acted as financial adviser on over \$30 billion of projects. Other banks describe RBS as the most competitive bank in both project finance and oil & gas, prepared to undercut and offer cheaper loans. Project finance league tables published in Petroleum Economist, Project Finance and Trade Finance magazines show RBS to be more involved in oil & gas than its British competitors.

RBS has made itself integral to every stage of oil and gas exploration, production and development:

- Exploration of new regions is financed by general credit and overdraft facilities that give the oil and gas corporation flexibility in spending.
- Construction of platforms to produce oil & gas is paid for with dollars from project finance and loans backed by the reserves in the ground.
- The crude is shipped from oil-rich areas to consumer regions via pipelines and tankers – constructed with project finance loans.
- Receiving terminals in consumer countries are the last stage in an integrated system of production, transport and delivery – requiring immensely complex loan agreements and financial advice.

RBS is not a distant investor but a hands-on partner, providing project & risk analysis, structuring loan agreements and bringing other banks on board. While BP, Shell and Exxon bring the oil out of the ground and ship it to the market, RBS corporate branding promises to "Make it happen"³. In December 2006, RBS took the next step and relaunched its sector website as "www.theoilandgasbank.com".

Through these activities, the bank is intimately involved in transforming the carbon locked in oil and gas reservoirs thousands of metres underground into atmospheric carbon dioxide – the main cause of climate change. If carbon dioxide molecules had corporate tags of responsibility, the atmosphere would be filled with RBS logos mingling with those of BP, Exxon and Shell.



Climate Chaos

*"Climate change is the most severe problem that we are facing today, more serious even than the threat of terrorism."*⁴

David King, UK government chief scientific adviser, January 2004

Climate change is the biggest threat to a secure future currently facing humanity. If current trends continue, average global temperatures could rise by 6.4°C by the end of the century with devastating and permanent results for the planet.⁵

Consequences will include floods, forest fires and droughts, the spread of disease and more extreme weather patterns.⁶ We will see widespread extinctions of plant and animal species.⁷ Changes in weather patterns, water supply and agricultural yields are expected to create hundreds of millions of environmental refugees. Rising sea-levels will threaten floodplains from Bangladesh to East Anglia. Drought patterns in Africa stand to worsen catastrophically.⁸ Annual disaster losses from extreme weather are predicted to hit \$150 billion a year by 2014⁹, and top \$1 trillion before 2040.¹⁰ Future generations will have to deal with a radically altered world.

Climate change is not a phenomenon of the future. The World Health Organisation estimates that it already causes 160,000 deaths each year. The 2003 heat wave in Western Europe led to over 50,000 deaths.¹¹ Hurricane Katrina killed close to 2,000 and tore a hole through Louisiana, Mississippi and Alabama, causing over \$120 billion in damages.¹² While direct links between individual weather events and climate change cannot be proven, scientists agree that the frequency and scale of extreme incidents will increase significantly.

The impacts are harshest for the world's poor.¹³ Food production, water supplies, public health, and people's livelihoods are being damaged and undermined. In Asia, serious floods have caused ruin in Nepal, India, China, Vietnam, Cambodia, and Bangladesh in recent years. In summer 2004, excessive rainfall in the Himalayas left two-thirds of Bangladesh under water, with over 50 million people affected and tens of thousands suffering from diarrhoea as sewage mingled with the floodwaters. Aid agencies are warning that global warming will increase inequality and reverse development.¹⁴

Climate change has been accepted as a major issue by every relevant and credible institution, including governments, corporations and civil society. Scientific research strongly confirms a direct relation between human activity, rising levels of atmospheric greenhouse gases and climate change. The Intergovernmental Panel on Climate Change (IPCC) – an official body comprising hundreds of the world's top scientists – has concluded that the combustion of fossil fuels (oil, gas and coal) is the largest cause of climate change. Significantly reducing greenhouse gas concentrations in the

atmosphere is the most direct way to lessen its impacts.¹⁵

Science indicates that we have little time to take action. Perhaps the greatest danger arises from the 'positive feedbacks' (self-reinforcing factors) within the earth's climate system. Beyond a certain point, climate change will accelerate and it may become impossible to stop matters deteriorating, however much we reduce our greenhouse gas emissions. For example, icecaps reflect sunlight: as they melt, the earth's system absorbs more of the sun's energy. Much of the arctic permafrost contains high levels of trapped methane, a greenhouse gas 21 times stronger than carbon dioxide. As the permafrost melts, the methane will be released into the atmosphere.

Major shift needed

Yet a rapid transition away from carbon fuels towards renewable energy production can still help the planet avoid the feedback loop that could lead to 'runaway' climate change. Achieving such a shift requires concerted action by individuals, governments and companies. Moves towards regulation on sub-national, national and regional levels mean that carbon emissions are beginning to carry a cost. While that cost currently remains low, increased policy measures and concerns over the impacts of climate change will lead to greater carbon constraints that carry real financial consequences for business. An analysis of the FTSE 100 by Henderson Global Investors calculated that the climate-related costs faced by some companies could eclipse their entire earnings.¹⁶ Even in the US, emissions regulations are being implemented. Eleven states have introduced caps on carbon emissions, while Citigroup believe that the "U.S. will follow the global trend toward constraining carbon emissions in the near future."¹⁷

Crucially, such action to mitigate climate change must incorporate the money behind energy production. The Institutional Investors Group on Climate Change, representing \$850 billion of assets, has argued that "investment decisions taken now will have a big impact on current and future global greenhouse gas emissions."¹⁸ Since oil and gas extraction projects usually last for 20-40 years, financing decisions made today risk locking in decades of high carbon emissions. Without a change in direction for the dollars and pounds flowing into fossil fuels, the energy framework of the 21st century will remain that of the 20th. Yet RBS appears unaware of the climatic risks involved, and continues to funnel cash into new oil and gas projects.

Making it happen

The RBS Oil & Gas Team

"Whether your oil and gas finance requirements are straightforward or complex, RBS will bring its broad and deep experience of the hydrocarbon sector to bear on them."¹⁹

RBS Oil and Gas Team

With dedicated oil & gas offices in London, Houston, Aberdeen and Norwich, RBS claims that its "knowledge of the industry, the bank's financial muscle and market presence and the long experience of our oil and gas bankers enable us to provide an unrivalled range of corporate and structured debt and advisory products."

RBS oil & gas operations are headquartered at 135 Bishopsgate, near London's Liverpool Street station. The London office, hosting the largest team of bankers in the City dedicated to cashflow-based lending in oil and gas, provides tailored loans and advises on deals for exploration, pipelines, gas liquefaction and regasification and oil refineries. On any weekday, the London team could be assessing the risks and reasonable returns for an Exxon oilfield development off Nigeria, advising on the loan agreement that will make the enormous Qatargas 4 project a reality or submitting an aggressive bid to finance a borrowing base agreement with the Angolan state oil company Sonangol.

Loans for North Sea operations and the oilfield service sector are issued primarily out of the Aberdeen and Norwich offices. RBS Houston provides oil companies large and small with "the full spectrum of the bank's products."²⁰ Recently, these have increasingly included non-conventional sources of fossil fuels including oilsands and coalbed methane.

Between 2003 and 2006, the RBS Oil & Gas Team provided or arranged finance for over 30 massive oil and gas projects, usually with significant political, environmental and technical risks. In many cases, the oil and gas advisory team also acted as financial adviser to the project operator.²¹ At least 17 more general corporate loans were disbursed, including borrowing base agreements backed by oil/gas reserves.²² These enabled borrowers such as Tullow Oil and Marubeni to expand exploration activities in Equatorial Guinea, Gabon and Bangladesh. 13 credit facilities were provided, including to ConocoPhillips to finance the acquisition of Burlington Resources and to Premier Oil to increase flexibility in exploring less established oil regions.²³

Chuck Zabriskie, Director of RBS Houston, understated the bank's activities, "The bank is very keen on the energy area."²⁴ More accurate is the team's more recent boast on its website that "we rank among the world's foremost energy sector banks". Competing banks and analysts regularly describe the RBS Oil and Gas Team as "aggressive" and the most competitive in the market.²⁵ In April 2006, while bidding to participate in a \$1.4bn loan to Angolan oil consortium Sonangol Sinopec, RBS significantly undercut all other banks, driving down the price of borrowing. This approach encourages oil/gas corporate clients to borrow

greater sums. When larger loans become possible, either through cheaper rates or through more banks than expected signing up, borrowers can speed up construction or increase production capacity. The RBS Oil and Gas Team is offering incentives that accelerate climate change.

In many ways, the RBS Oil & Gas Team operations resemble those of an oil and gas service company— providing the risk advice and loan agreements that are as central to oil production as drill bits and pipeline coating. The Houston offices include a team of petroleum engineers who focus on development financing for smaller producers with limited expertise. The in-house technical staff analyse sub-surface risk, providing RBS with geological and reservoir engineering expertise.

The intimate relationship between RBS and fossil fuel industries runs higher up the corporate ladder. The RBS board has significant mixed interests, with several directors also serving on the boards of major oil companies. Chairman Tom McKillop manages to fit in a directorship at BP, with BP Chairman Peter Sutherland reciprocating as non-executive director of RBS. Non-executive director Bill Friedrich is also deputy CEO at BG, operator of the Egypt LNG project that received multi-billion dollar loans from RBS. Jim Currie is a director of both RBS and the UK branch of Total, the world's fourth largest private oil company.

On its old website www.rboilandgas.com, the Oil & Gas Team boasted of "over 30 years experience in providing tailored solutions to the oil and gas sector" and a philosophy of "making it happen". "It" appears to be climate change.

"Our track record and expertise in the sector make us the bank of choice for independents in the North Sea."²⁶

Steve Mills, Head of RBS
Oil & Gas, London

Case Study: Oil Field development - North Sea

RBS claims to have been involved in financing North Sea oil exploration and production "since the beginning"²⁷ With the oil and gas majors (BP, Shell, Exxon...) providing less of the new investment since production peaked, the RBS team has specialised in servicing smaller, independent companies. These tend to be less experienced, and thus rely on RBS for hands-on support, including financial modelling, risk analysis and project advice.

Most recently, RBS has worked closely with Canada-based Oilexco to develop the Brenda and Nicol oilfields. Arthur Millholland, president of Oilexco, recognised the importance of having RBS on board, "As we proceed towards the development of the Brenda oil field, having access to the experience and advice of the Royal Bank of Scotland will be of great assistance to us."²⁸

In Jan 2006, RBS and Oilexco signed an engagement agreement that identified RBS as the sole adviser, arranger and provider of a \$280 million loan. Oilexco announced, "The bridge financing [...] will allow us to get an early start on implementing our development plan."²⁹ Once fully operational, the Brenda and Nicol fields are expected to produce 56,000 barrels a day.

RBS has run an annual North Sea Oil Conference in Aberdeen since 2001, bringing together investors, oil companies and government. Featuring keynote speakers including BP's John Browne and Shell's Malcolm Brinded, the conference is seen as "a key industry forum promoting interest and investment in the North Sea"³⁰



Photo: Jeff Jones

Emissions embedded in RBS transactions

“The investment that takes place in the next 10- 20 years could lock in very high greenhouse gas emissions for the next half-century, or help move the world onto a more sustainable path.”³¹

The Stern Review

RBS has now accepted the need to calculate and publish its “internal” carbon emissions resulting from its computer screens, heating of buildings and travel. However, it refuses to accept responsibility for its “embedded emissions” – those resulting from its core business of providing loans, advice and financial transactions.

Banks generally have relatively low internal emissions, as they don’t run factories, control major infrastructure or use heavy machinery. Reducing existing internal emissions further is reasonably easy, through insulating buildings, increasing computer screen efficiency and replacing flights with teleconferences. This enables the bank to cut operating costs while claiming environmental responsibility. In its Corporate Responsibility reports, RBS claims to have cut internal emissions by 19% between 2000 and 2004. Future targets include reducing electricity and oil and gas consumption per pound earned by 5% by 2010.

RBS internal emissions vs RBS embedded emissions

'000 tonnes /year

	2001	2002	2003	2004	2005	2006
<i>Internal</i> ³²	245	310	327	380	318	
<i>Embedded</i>	8023	8528	13122	25704	36907	43690

This decrease pales into insignificance compared to the rapid increase in annual embedded emissions resulting from financing oil and gas. RBS project loans to oil and gas alone caused 36.9 million tonnes of CO₂ emissions in 2005. The bank’s embedded emissions are equivalent to more than those of one quarter of all UK households (6.2 million).³³ The methodology for calculating embedded emissions is detailed in Appendix 1.

Annual embedded emissions are cumulative, the result of projects financed in that and previous years. They only begin to fall when a project is decommissioned – generally 20 to 30 years after financing.

In this graph (Fig. 1), annual RBS emissions are compared to those of Scotland. The bank has significantly increased its financing of oil and gas projects since 2000, causing a sharp rise in annual embedded emissions. Provisional figures for 2006 show that RBS emissions have overtaken those predicted for Scotland.

If RBS finances no further fossil fuel projects, its emissions curve will plateau in 2007. Emissions will not decrease until after 2020, when the first projects will be decommissioned. If RBS finances new projects, the graph will continue its steep rise.

As noted above, the emissions caused by the original financial transaction continue to be pumped into the atmosphere decades after a deal is signed or a loan transferred. Another way of counting RBS’ embedded emissions is to allocate the emissions expected across the lifetime of a project to the year in which RBS decided to finance the project, when the bank effectively locked in the creation of those emissions.

For example, BP’s Baku-Tbilisi-Ceyhan pipeline pumps one million barrels of oil a day, equivalent to 160 million tonnes of CO₂ a year. RBS provided a \$100m loan to the \$3.6bn project in February 2004, taking on responsibility for 2.77% of its annual emissions – 4.44 million tonnes of CO₂. If the project operates only for a conservative 15 years, the RBS loan in 2004 will have locked in 66.6 million tonnes of lifetime emissions.

Looked at this way, RBS project-related financial services between 2001 and 2006 locked in 655.3 million tonnes of CO₂ emissions – more than equivalent to the UK’s entire 2005 emissions. Fig 2 compares Scotland’s annual emissions with those locked in each year by RBS financial services to oil and gas projects. Unlike the annual emissions in Fig 1, lifetime emissions are not ongoing. If RBS finances no oil and gas projects in 2007, it will create no additional lifetime emissions.³⁴

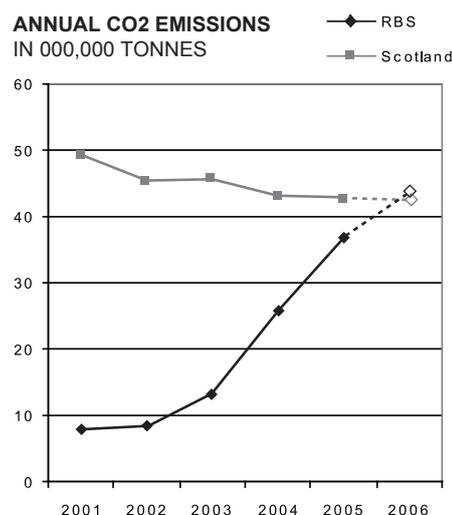


Fig. 1

The embedded emissions described above are those resulting solely from RBS' provision of project finance loans. In reality, the bank contributes to the creation of further emissions through other financial services, including acting as mandated arranger or as financial adviser, and through provision of general corporate loans. Between 2004 and 2006, RBS organised the financing of projects that will cause over 242 million tonnes of CO₂ per year. A proportion of these emissions are embedded in RBS' products. However, lack of transparency and the non-existence of accepted standards makes their calculation difficult.

Along with other financial institutions, RBS has received credit for "transparency" after responding to the Carbon Disclosure Project (CDP) questionnaire. However, answering the CDP questions does not mean RBS is taking its carbon responsibilities seriously. Rather, through the focus on internal emissions, RBS has been able to hide its far more relevant embedded emissions.

RBS LIFETIME EMISSIONS VS SCOTLAND EMISSIONS

in 000,000 tonnes

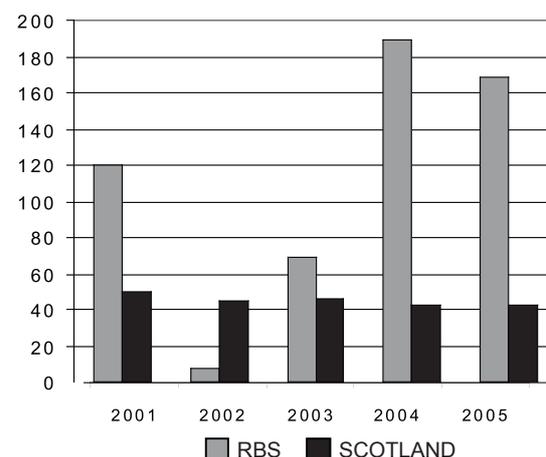


Fig. 2

Case Study: Liquefied Natural Gas – Qatar and beyond

The RBS Oil and Gas Team has helped drive the take off of Liquefied Natural Gas (LNG) projects over the last ten years, participating in over \$30 billion of deals.³⁶ In 2005, RBS was the top adviser and lead arranger to the global LNG industry. Steve Mills, Head of RBS Oil & Gas, recognised that "the final hurdle for [LNG] development projects will be access to capital", and positioned RBS' "considerable LNG financing experience evaluating the risks associated with LNG projects to determine how to best structure a financing."³⁷ Steve Mills himself was central to the major wave of liquefied natural gas projects in the Middle East, Europe and the US over the last 10 years.

RBS has dominated the financing of LNG projects in Qatar, the major hub of production in the Middle East, working closely with Qatar Petroleum, Exxon and Shell since 2004. Qatar's North Gas Field is the largest pure gas reservoir in the world. Projects currently in construction include the Dolphin Gas Project to develop a gas field and build two 400km pipelines, the \$10bn RasGas II & III, \$9.3bn Qatargas 2, \$5.8bn Qatargas 3 and \$4.8bn Qatargas 4 LNG liquefaction plants, and construction of the world's largest dedicated fleet of specialist LNG tankers. Gas from Qatargas 2 will be consumed in the UK, after being shipped to Exxon's South Hook regasification plant in Pembrokeshire – also financed by RBS.

Once constructed, the five Qatari LNG projects alone will have a cumulative production of 60.9 million tonnes of LNG per year. Once consumed, this will be transformed into annual carbon emissions of 156.9 million tonnes – over three times Scotland's annual emissions.

"RBS intends to remain at the forefront of LNG finance"³⁵

Steve Mills, Head of RBS
Oil & Gas, London

Natural gas is a less dirty fuel than coal or oil. Per unit of energy, gas produces 70-80% of the CO₂ emissions released by consumption of oil, and 50-60% of those of coal. Thus, replacing coal-fired power stations and oil-based transport with gas will reduce carbon emissions in the immediate term. However, gas is only a temporary step from fossil fuel-dependence to a low carbon economy. If no fossil fuels except remaining natural gas reserves are consumed, the planet's atmosphere could still reach a dangerously high level of carbon parts per million.

Furthermore, the projects financed by RBS are not producing gas to replace coal and oil extraction and consumption, but to feed new markets. Financing the extraction and transportation of gas in addition to oil and coal will not reduce or even limit carbon emissions.



Liquefied Natural Gas is highly explosive, making LNG tankers likely targets for attacks, as seen in the film *Syriana*.

Breaking open the oil & gas frontier

RBS has manoeuvred itself into a position where it is intimately involved in forcing open the oil & gas frontier. As extraction in traditional oil regions peaks and begins to decline, oil and gas corporations are searching further afield, moving into the deep waters off West Africa, landlocked countries of Central Asia and the frozen Arctic. Opening up this new carbon frontier involves deeper drilling, longer pipelines and new technology to deal with adverse weather conditions.

As project costs rise, oil corporations are unwilling or unable to finance expensive projects from their balance sheets, particularly alongside potentially high risks. Instead, they rely on banks to cover up to 90% of construction costs. Further increases in oil/gas production will require significant capital, but will bring major profits. RBS appears to be positioning itself to take advantage of this trend, and aims to increase its involvement yet further.

Many regions within the new oil and gas frontier are ecologically and politically fragile. Intensive exploration and production activities result in sudden construction of major infrastructure, an influx of thousands of employees into often sparsely populated areas and the introduction of contracts that over-ride local law. This frequently carries negative impacts on the environment and local lives. RBS cannot dissociate itself from the risks of pollution, abuse of human rights and loss of land that its financing contributes to.

Case Study: Sakhalin II – ice, gas and whales

The RBS Oil and Gas Team has been bidding for over a year to become lead arranger for Shell's Arctic debacle – Sakhalin II. With the project involving major political risks and a terrible environmental record, RBS is one of only six banks potentially still interested in arranging finance for the project.

Sakhalin II is a \$20bn integrated oil and gas project constructed largely by Shell on Sakhalin Island, off Russia's east coast. The project consists of offshore drilling rigs, undersea pipelines, onshore pipelines stretching the length of the island and the world's largest LNG liquefaction plant.

Over its life-time, Sakhalin II will pump 17.3 trillion cubic feet of natural gas and 1 billion barrels of oil, causing total emissions of 1539 million tonnes.

Sakhalin II threatens the critically endangered Western Gray Whale with extinction³⁹ by building the offshore drilling rigs adjacent to the whale's only known summer feeding ground. The habitats of endangered bird and fish species have been severely damaged while indigenous communities complain that they were misled, their fish resources damaged and their way of life disrupted.³⁹ The project operator Shell has reportedly misrepresented environmental data and ignored advice from its own consultants.⁴⁰

RBS is fully aware of the problems with Sakhalin II,⁴¹ yet has pressed ahead with its bid to finance the project. In late 2006, the Russian Ministry of Natural Resources attempted to withdraw Sakhalin II's environmental permits. Despite the Ministry dropping legal proceedings following Gazprom's involvement in the project as majority stakeholder, major concerns remain regarding environmental violations.



*Sakhalin II construction, Russia
Photo: Sakhalin Environment Watch*

Case Study: Niger Delta – satellite fields, conflict and kidnappings

In December 2005, RBS and three other international banks arranged a \$270 million loan to the Satellite Oil Fields Project in the Niger Delta. Operated by Exxon and Nigerian National Petroleum Corporation, the project aims to extract up to 125,000 barrels a day from five oil fields, including Abang, Oyot and Itut. This is the first phase of longer term plans to develop 22 fields over the coming years; the Exxon/NNPC concession area is believed to contain 6.5 billion barrels of oil.⁴²

The crude from these fields will be pumped to the onshore Qua Iboe Terminal for storage and export. Exxon's failure to pay compensation for a 1997 oil spill, despite a court ruling, led to official evacuations following threats to shut-down the Qua Iboe Terminal by the Movement for the Emancipation of the Niger Delta in April 2006.⁴³ Recently, Exxon has attracted increasing community opposition. In October 2006, five foreign oil workers were kidnapped from near the Eket Exxon operational base.

Oil and gas extraction in the Delta is widely recognised as one of the primary drivers for conflict, corruption and underdevelopment.

⁴⁴ Spills and gas flaring have caused illness and led to community resistance, most famously in the case of the Ogoni.

Acting as mandated arranger, RBS was closely involved in structuring the loan package for the Satellite project. Financing was accelerated by excluding export credit agencies and multilateral banks, as these institutions require increased levels of due diligence. The loan terms tie RBS to the project for a particularly long period. Pierre Palmieri of Societe Generale, also involved in the deal, admitted that the project "is a perfect example of transactions where a bank needs a strong technical expertise in upstream oil financing and experience in working in emerging countries."⁴⁵

Case Study: Baku-Tbilisi-Ceyhan pipeline – crude oil, repression and mineral water

RBS was the only British bank to participate in a \$1.6 billion loan agreement for BP's Baku-Tbilisi-Ceyhan pipeline (BTC), agreed in February 2004. Over two years later, what the Financial Times described as "one of the world's most controversial oil pipeline projects" had begun to pump crude oil from the Caspian Sea across the Caucasus and Turkey and on to tankers in the Mediterranean port of Ceyhan.

BTC is built to carry one million barrels of oil a day to Western markets for forty years. When consumed, this oil will release 160 million tonnes of carbon emissions into the atmosphere every year – 28% of total UK annual emissions.

Three years of construction have severely disrupted the environment and local residents' lives. BTC props up authoritarianism in Azerbaijan, has rendered numerous Georgian homes uninhabitable and polluted water supplies, and led to intimidation of critics and the Kurdish population by the Turkish state. Turkish fishermen have lost their livelihood and the pipeline threatens the Borjomi National Park, source of Borjomi mineral water, Georgia's largest export. The legal contracts underwriting BTC restrict future governments from introducing new laws - including environmental, human rights or labour laws - which could reduce profitability.⁴⁶

The RBS Oil and Gas Team and corporate responsibility officers were warned repeatedly⁴⁷ about serious social and environmental failures, yet refused to take action and provided \$100 million for the project. Steve Mills proclaimed that "As a lender we are satisfied that the appraisal and monitoring process is robust."⁴⁸ This could yet come back to haunt RBS, with lawyers suggesting the bank

could be liable for knowingly permitting environmental crimes to take place in Azerbaijan and Georgia if pipeline leaks result from the faulty anti-corrosion coating used.⁴⁹



Tap water polluted by BTC construction in Tsemi, Georgia
Photo: PLATFORM

Our energy future: two opposing choices for RBS

Non-conventional fossil fuels & coal

RBS' embedded emissions look set to grow not only through increased loans to the oil & gas sector, but through an additional focus on unconventional "dirty" oil, unlocking previously inaccessible fossil fuels from coal bed methane and oil sands. Jim McBride, from RBS Houston, has argued that "In the future, we believe there's going to be as much as \$40 billion spent on oil-sands development in Canada, so this is another energy-financing growth area for us. In addition, in terms of coalbed-methane development, Canada is probably about 15 years behind the U.S. . . Again, drilling dollars will be needed."⁵⁰

Strip-mining and drilling for tar sands threatens to turn the boreal forest and wetlands, both major carbon storehouses, into wastelands.⁵¹ The high level of energy needed for conversion of tar sands to synthetic oil means that the production process itself emits up to three times that of conventional crude. Furthermore, toxic tailing ponds and water pollution are raising concerns regarding surprisingly high levels of cancer in nearby communities.⁵²

On its website, RBS already claims "extensive experience in providing financing to unconventional oil & gas development"⁵³ Acting as lead arranger for loans totalling \$800 million for the Long Lake Oil Sands project in 2004 and 2006, the bank is facilitating the production of 120,000 barrels of crude a day from heavy oil sands. In 2003 it was co-lead investor for a \$70m loan to Quicksilver Resources, a coalbed methane operator.

RBS has also recently financed conventional coal companies, including acting as bookrunner for an \$8.5 billion loan to Xstrata⁵⁴, the world's largest producer of export thermal coal, used to produce electricity.⁵⁵

Although RBS is correct that unconvensionals currently represent a growth area, there is a tight limit on the level of sector growth the planet's atmosphere will accept. The extraction and conversion of unconvensionals into usable fuels is a major threat to global attempts to rein in carbon emissions, exposing the sector to unpredictable and volatile uncertainties.⁵⁶



*Oil sands mine in Alberta, Canada
Photo: David Dodge, The Pembina Institute*



Photo: Peter Sitzer

Renewable Energy

Alternative energy is a growth sector in need of capital. Increasingly favourable regulatory environments and long-term commitments by both governments and companies to major emissions cuts make carbon friendly companies and projects attractive investment targets in the long and short-term.

In 2005, the market for wind and solar equipment and services rose to over \$20 billion. While still significantly smaller than that for conventional energy, annual growth rates are around 25% for wind and over 30% for solar. Conventional energy sector growth remains around 2-3%.⁵⁷ Given corporate, state and consumer behaviour, growth rates for renewables as well as energy efficiency and sustainable transport are likely to remain very high.

Renewable technologies including wind and solar are now mature, with reduced technical risk for their customers.⁵⁸ Large wind farms need significant capital and can sign long-term electricity-sales contracts, making them particularly suited to project finance. Most renewable technologies run on free fuel, and hence have low operating costs. Maintenance expenditure is low, and construction costs covered by up-front capital. Unlike gas, coal and nuclear power plant, operational and price risk are minimal.

RBS has already been involved in a small number of renewables projects, including the \$60m Canunda Wind Farm in Australia and a \$169m windfarm build by Edison in Italy.⁵⁹ Between June 2004 and May 2005, the bank was not in the top 10 arrangers or providers for global renewable project finance loans.⁶⁰ However, between January and August 2005, the bank became the 9th largest global mandated arranger, arranging two deals worth a total \$136m.⁶¹ Yet this remains tiny compared to its fossil fuel portfolio.

Switching to a low carbon economy will require rapid development of renewables and energy efficiency projects. RBS can carve out a responsible and profitable role in achieving this, if it so chooses. It is still possible to morph its identity from "the oil and gas bank" to "the low carbon bank". However, financing renewable energy must be an alternative, not an additional, target for loans – renewable energy itself does not reduce the embedded emissions RBS causes through financing oil & gas.

The Responsible Bank of Scotland?

"As a financial services group our direct impact on the environment in terms of climate change, use of resources and biodiversity is limited compared to many other business sectors. Nevertheless we realise the importance of reducing the impact of our business on the environment wherever possible."

RBS 2005 Corporate Responsibility Report

RBS likes to present itself as a responsible member of the community, paying attention to consumer satisfaction, employee happiness and environmental impacts. RBS prides itself on being a lead banker for UK charities and higher education. Yet the high levels of embedded emissions and destructive projects financed conflict with the rhetoric of sustainability.

The Corporate Responsibility report released by RBS in 2006 focuses on donations to charity, combating fraud and small business lending in the UK. It makes much of the £56.2m invested by RBS in UK community projects.⁶² While these activities are valuable, they are a small part of the picture. RBS is a global bank with global investments and thus global impacts. There is no mention in the report of the many controversial projects funded by RBS from the Caucasus to the Amazon⁶³, from Angola⁶⁴ to Wales⁶⁵.

In 2005, the RBS Corporate Markets division delivered a higher proportion of total income (33%) than Retail Markets (31%). Yet the social and environmental impacts of corporate lending and investment are barely touched on in the report. Out of 36 pages, only 3 short paragraphs are devoted to Corporate Markets.⁶⁶

RBS: a laggard on climate change policy and process

RBS is a laggard on climate change compared to other major banks, having neither acknowledged its major impacts on the planet's climate nor adopted a comprehensive policy on climate change. The bank prides itself for signing on to the Equator Principles, voluntary guidelines aiming to reduce social and environmental risk. However, the Principles do not specifically address greenhouse gas emissions and were never intended to deal with climate change.

In recognition of this, other major banks have begun to adopt and implement specific climate change policies. The Co-operative Bank is ahead of the game, with no exposure to oil, gas or coal. HSBC recognises that its "most significant impact [on climate change] is the investment and lending decisions we make. Therefore, we are looking at solutions to climate change through our investments and funding."⁶⁷ The CEO of HBOS' asset management arm Insight has argued, "Tackling climate change will hinge on the investment decisions made by institutional investors."⁶⁸ Bank of America has begun an assessment of CO₂ emissions resulting from its energy and utilities portfolio, and has committed to reducing these emissions by 7% by 2008.⁶⁹ Citigroup and JP Morgan Chase have recognised a responsibility to stimulate their clients to reduce their CO₂ emissions.⁷⁰

It has also become increasingly common for banks to internalise climate change risks into their lending decisions. Assessments of the costs of carbon emissions and climate change to clients' businesses are integrated into decision-making processes. A report produced for Friends of the Earth Netherlands claimed that at least eight major international banks have climate change related criteria for their loans.⁷¹

While no bank is currently beyond criticism regarding policies adopted and implemented to address carbon responsibilities, RBS lags behind its national and international competitors. Despite claims to the contrary, it is not "reducing the impact of [its] business on the environment wherever possible".

Conclusion

The Stern Review commissioned by the UK government highlighted the economic consequences of not tackling climate change effectively and the future costs of current investment decisions. Financial institutions have a crucial role in determining the energy sources and fuels that will power the world over the coming century.

The financing of new oil and gas extraction and supply creates the necessary conditions for accelerated climate change. The Royal Bank of Scotland is the primary bank providing the financial fuel that intensifies the climate threat, making claims of environmental responsibility appear hollow. Working primarily out of the City of London, the RBS Oil and Gas Team is intimately involved in making the construction of new drilling rigs, pipelines and tankers possible.

While RBS has capped its comparatively small internal carbon emissions, the emissions embedded in its financial transactions are soaring, reaching 36.9 million tonnes in 2005, 116 times RBS internal emissions. Preliminary figures for 2006 show that RBS annual embedded emissions have overtaken Scotland's annual emissions. The thirty oil and gas project finance deals signed between 2001 and 2006 locked in embedded emissions of more than 553.6 tonnes over the next 15 years.

The growing pressure from society, governments, business and international institutions for action on climate change brings significant regulatory, operational, litigation and reputational risks. Climate change is becoming a mainstream consumer issue, threatening brand value. Fund managers are increasingly aware that the carbon emissions of companies are an important source of risk and cost at a portfolio level.⁷² While current emission regulations target greenhouse gases emitted directly rather than those embedded in transactions, any non-predicted or accelerated climatic impacts will likely result in sudden and harsher regulation. As the impacts of climate change become ever more apparent, frustration will be targeted at those companies seen as responsible. The self-assigned title "The Oil & Gas Bank" could soon become a liability rather than a badge of success.

RBS is faced with a choice – to continue locking in very high greenhouse gas emissions to our future, or to shift its focus to the low carbon technologies that can define a sustainable energy path.

This report recommends that RBS:

- Recognise the full implications of its operations on climate change, including the core business of financial services. Introduce a comprehensive climate change policy addressing and reducing these impacts.
- Calculate, publish and cap embedded carbon emissions. Introduce reporting mechanisms that include provision of financial advice and arranging loans. Announce a target for annual reductions and the strategy to achieve this.
- Replace the Oil and Gas Team with a Sustainable Energy Team, the majority of whose investments are in renewable energy and energy conservation. Shift its portfolio away from projects and companies directed at expanding fossil fuel use. In particular, make a commitment to divest from current and avoid future oil and gas investments.
- At an absolute minimum, make no future loans to coal or unconventional oil and gas projects or companies, including oil sands and coal bed methane.⁷³

Appendix 1: Methodology

This report focuses on the climate change impacts of RBS' exposure to oil/gas project financing. Therefore, embedded emissions have been calculated as the emissions that will result from oil or gas produced or brought to the market from operations financed through project finance.

Embedded emissions created through general corporate financing and asset management of fossil fuel extraction, energy utilities, transportation and other sectors are not included in these calculations. It is likely that these are also significant.

Figures for embedded emissions provided here are not wholly comprehensive due to a lack of transparency and public data, but do provide a reasonable estimate of RBS' role in causing climate change. Furthermore, we hope that publication of this report will spur momentum for just such transparency, pushing banks such as RBS to publish their embedded emissions in a verifiable way.

The data was gathered primarily through Thomsons' Financial, Euroweek and publications by RBS and its clients. In the case of many loans, only some data was publicly available, and it is possible that details changed after publishing. All efforts were made to identify individual loans and avoid counting loans twice.

1) Converting between crude oil, natural gas and LNG

Barrels of crude oil, tonnes of LNG and cubic feet of natural gas were converted into tonnes of oil equivalent using BP's conversion calculator.⁷⁴

2) Converting crude into CO₂

Calculating the carbon emissions that can result from a barrel of oil or a ton of gas is necessarily imprecise, as final emissions depend on the intermediary refined product and on final use.

The factors used in these calculations were:

1 ton of oil equivalent of natural gas > 2.094 tonnes of CO₂⁷⁵

1 ton of crude oil > 3.2 tonnes of CO₂

1 barrel of crude oil > 0.4366 tonnes of CO₂

These factors are the averages of several values derived from analyses of the combustion of a variety of refined products.⁷⁶ The most divergent values for crude were 0.4251 and 0.4487. The divergence in this case is less than 6%.

3) Annual embedded carbon emissions

The bank was allocated carbon emissions according to the level of finance it provided to a particular project. While RBS bears responsibility for emissions embedded in other financial services, including acting as financial adviser or mandated arranger, these were not calculated. Total project costs can increase and decrease during the projects lifetime, therefore these calculations were made on the basis of the original project costs.

To maintain consistency, it was assumed that the bank tranche was shared equally

amongst participating banks. The bank was allocated a proportion of the carbon emissions resulting from products extracted equivalent to the proportion of the project cost it provided. No distinction was made between capital provided as equity and that as debt.

e.g. BTC project costs: \$3600m

Bank tranche: \$1600m

Banks involved: 16

RBS provided: $1600/16 = \$100\text{m}$

Proportion of emissions allocated to the bank: $100/3600 = 2.77\%$

Annual project emissions: 160 million tonnes

RBS annual embedded emissions: $2.77\% \times 160 \text{ million} = 4.44 \text{ million tonnes of CO}_2$

4) Lifetime embedded emissions

Lifetime embedded emissions were calculated by multiplying the annual embedded emissions caused by one year's project financing with a value representing the average oil & gas project lifespan. Oil and gas projects tend to operate for between 10-40 years. 15 years was selected as a value at the low end of the spectrum.

Appendix 2: Companies bankrolled by RBS

Sonangol (Angolan State Oil Company)

Daily oil extraction: 750,000 barrels

Annual CO₂ production: 120 million tonnes

RBS contributed to three loans totalling \$6.65bn. Aggressively undercut other banks in bidding for the third.

Areas of operation: Angola

Oil-backed loans to Angola have been criticised by the World Bank as the core obstacle to development and for undermining IMF transparency standards.⁷⁷ Global Witness condemned the loans as perpetuating chronic corruption and poverty.⁷⁸

Tullow Oil (Ireland)

Daily oil extraction: 69,000 barrels

Annual CO₂ production: 11 million tonnes

RBS was the lead arranger for an \$850m borrowing base facility.

Tullow explores and produces oil in Africa, South Asia and the UK North Sea and has 358 million barrels of reserves

Areas of operation: Gabon, North Sea, Pakistan, Angola, Equatorial Guinea, Congo

Oil production in Equatorial Guinea has been severely criticised for propping up the repressive dictatorship and encouraging corruption.⁷⁹

Premier Oil (UK)

Daily oil extraction: 33,000 barrels

Annual CO₂ production: 5.3 million tonnes

RBS was the lead arranger for a \$275m credit facility.

Premier Oil is a medium-sized oil and gas company focusing on exploring in less established regions.

Areas of operation: Mauritania, Gabon, Guinea Bissau, Egypt, Pakistan, Indonesia, Philippines, Vietnam, India, Norway, UK

Premier long operated in Burma, supporting the military dictatorship, until forced to pull out by a successful student and activist campaign.⁸⁰

ConocoPhillips (USA)

Daily oil extraction: 1,507,000 barrels

Annual CO₂ production: 240 million tonnes

RBS was administrative agent for \$15 billion of credit to facilitate ConocoPhillips' acquisition of Burlington Resources.

The world's fifth largest private oil company. Integrated petroleum company exploring for and producing crude oil, natural gas and oil sands.

Areas of operation: Alaska, East Timor, Colombia, China, Nigeria, Venezuela, the Caspian
Burlington Resources' operations in the Ecuadorian rainforest caused conflict with four indigenous nations through seismic testing, military repression and lack of consultation.⁸¹



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Appendix 4: List of projects and corporate loans

Project Finance

Project/Company Name	Year	Description	Sponsors	Capacity
RasGas 2 & 3	2005	LNG	Qatar Petro, Exxon	29.7 MTA
Dolphin Gas Project	2005	gas pipelines	Total, OXY	3.2 bcf/d
Egyptian LNG Train 2	2005	LNG	BG, Petronas	3.6 MTA
Egyptian LNG Train 1	2004	LNG	BG, Petronas	3.6 MTA
Qatargas4	2006	LNG	Shell, QP	7.8 MTA
Qatargas 3	2005	LNG	QP, ConocoPhillips	7.8 MTA
South Hook LNG	2005	LNG regas	Exxon	7.8 MTA
Qatargas 2	2004	LNG	QP, Exxon	15.6 MTA
Qalhat LNG	2004	LNG		3.3 MTA
Oman LNG	2001	LNG	Oman, Shell	6.6 MTA
Satellite Oil Field Project	2005	oilfield	Exxon, NNPC	125000 b/d
Cameron Highway	2003	oil pipeline	Enterprise Products Partners	600000 b/d
Reganosa LNG regas	2005	LNG regas	Endesa	7.2 MTA
SEA Gas	2002	gas pipeline	SEA Gas	125 PJ/year
Hamaca Oilfield Project	2001	oilfield	ConocoPhillips, Chevron	190000 b/d
Baku-Tbilisi-Ceyhan	2004	oil pipeline		1000000 b/d
OCP pipeline	2001	oil pipeline		450000 b/d
Energy Transfer	2004	oil pipeline	Energy Transfer	1.3 bcf/d
Gasandes Chile S.A.	2003	gas pipeline	Gasoducto Gasandes, Total	0.353 bcf/d
Freeport LNG	2005	LNG regas	ConocoPhillips	1.75 bcf/d
Oilexco	2006	oilfield		56000 b/d
Cairn Energy	2006	oil & gas fields		125000 b/d
Canaport	2006	LNG	Repsol, Irving Oil	1 Bcfd
Kitimat	2006	LNG	Galveston LNG	1 Bcfd
Gulf LNG (US)		LNG	Gulf LNG Energy	1.5 Bcfd
Sonora Pacific (Mexico)	2005	LNG		
Sempra Energy LNG	2004	LNG		
Oman LNG	2005	LNG		
Atlantic LNG1 (Trin & Tob)	2003	LNG		

Appendix 4: List of projects and corporate loans

Non-Project Finance

Non-project finance	Year	Description	Total embedded emissions:	RBS Loan
Tullow Oil	2005	crude oil	850	121.4
Ascent Energy	2005		105	26.25
Marubeni Oil& Gas Ltd	2005		250	
Energy North Sea Ltd/ Marubeni Oil & Gas	2005	crude oil	560	35
El Paso	2003		500	
Venture Production	2005	crude oil	175	
Venture Production		crude oil	375	62.5
Venture Production		crude oil	641	363
Russneft	2005	crude oil	300	140
Sonangol Sinopec	2006	crude oil	1400	105
Edinburgh Oil & Gas plc		crude oil	105	
Sonangol		crude oil	2250	
Sonangol	2005	crude oil	3000	
SOCAR	2006	crude oil	750	
Rosneft	2005	crude oil	2000	
Rosneft		crude oil		
Rosneft		crude oil		
Gazprom	2005	gas	1100	
Gazprom	2004	gas	1100	
Gazprom	2004	gas	1100	
Opti Canada Inc	2006	oil sands	800	
KCS Energy	2005		435	
Premier Oil	2005	crude oil	275	

