Ecofin Podcast

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Greetings from London, my name is Matt Breidert, head of Energy Transition strategies at Ecofin, part of TortoiseEcofin.

We wanted to take a look at the upcoming Presidential election, the differences between the candidates and platforms as regard to overall energy policy, and examine how outcomes might impact recent trends and our investment framework.

With a wrap now on the two major party primary conventions and the next big milestone being the September 29 debate, let's take a look at how the energy-related areas of the pre-convention and convention weeks compared:

For the Democrats and Joe Biden, the predominant theme around energy was climate change, elevation of climate change policy issues and substantial job opportunities for Americans in addressing them. In fact, the topic of climate change and related opportunities for the overall economy was one of the four pillars of their entire convention platform for 2020, integrated into an overall vision of revitalisation of America.

Specific policy pledges include:

- Rejoining the Paris Climate Agreement, and on day one seeking higher ambitions from nations around the world, likely directed at China
- Achieving net-zero GHG emissions at a national level by 2050 (matching the EU)
- $2 Trillion in spending package on accelerated renewable infrastructure to cut greenhouse gas emissions in the electric utility industry, with a goal to zero net carbon by 2035

So the first takeaway from such an ambitious program on energy transition, particularly achieving the 2035 zero net carbon target for utilities is: 'how can it happen'. And the answer is likely to be 'beware the aspiration vs the outcome'. First, to pass such a target, it would likely take both chambers of Congress to flip Democratic and then be able to survive a filibuster challenge, requiring 60 votes in the Senate. The most optimistic outlook for the Senate results fall well short of that expectation this year. Also, most utility industry insiders—including the big renewables proponents—understand a 2035 timeline to zero net carbon with a utility system already as large and advanced as the U.S. has is nearly impossible. The goal is thus likely aspirational, in part to maintain fidelity from the progressive side of the party. Nonetheless, the reality of the competitive cost position of adding more renewable resources, and the large pool of jobs in the industry already (which over 855,000 direct and indirect jobs is one of the largest pools of employment in the energy overall industry), a very substantial effort could be launched. At a minimum we would expect efforts to revive and extend expiring tax subsidies for the renewable industry. There also remains some possibility of a market-based carbon pricing scheme being enacted (but most likely with a political horsetrade on energy policy overall). We think protections from the FERC on renewable resource priority could be attempted to be addressed.

For the Republicans and Donald Trump, the predominant new theme or focus point around energy was.basically nothing. In fact, for the first time since the party was founded in 1854, they didn't update or amend their stated party platform, but rather kept their 2016 platform, word for word, including around energy policy.

So Mr. Trump and the Republican party are effectively 'doubling down' on their existing energy policy. Perhaps they feel they have accomplished a great deal already, relative to their stated goals, which as a reminder included:

- Exiting the Paris Climate Accord
- Devolving the Federal Environmental Protection Agency to states and limiting its overall purpose and reach
- Abolish the 'Clean Power Plan'
- Enacting a Presidential Permit to approve and complete the Keystone XL pipeline
- Opening further of public lands and outer continental shelf to fossil fuel exploration, with a cornerstone enactment recently to open the Artic Wildlife Refuge to energy lease permitting
- Reduce permitting and lease restrictions and of course improve timelines for proposed energy projects

According to our research, the only utterance of the word ‘climate change’ during the entire week came in a comment from Mike Pence, saying “Joe Biden would abolish fossil fuels, end fracking and impose a regime of climate change regulations”. Nothing even from any of the major members of the party like Kevin McCarthy or Marco Rubio who have jurisdictions deeply impacted by climate change risks and who themselves are talking about the issue. It’s not only not an issue for this party leadership, it’s just not to even be spoken about.

Democrats were alarmed about the Trump climate and energy platform in 2016, so how should they and investors feel if we end up with a reelection of the President? Well it might sound yucky to climate change focused investors but it may taste better than expected.

Perhaps an informative capsule illustrating the relative importance of the administration’s policy on climate issues can be found in the highly visible political support for the coal industry that Trump promised during his 2016 candidacy and in his post-election actions. Trump’s promises and efforts to revive the coal industry however have been more or less a failure. And it hasn’t been for lack of trying. Consider the following:

- Trump did move to remove the United States from its prior commitment to the Paris Climate Accord in 2017. The speech was attended by all the major CEO’s of the U.S. coal industry.
- Trump’s Head of the EPA is today a former coal lobbyist
- That same EPA proposed the ‘Affordable Clean Energy’ plan in 2019 intended to replace the Obama administration’s ‘Clean Power Plan’, which rather than promoting phase-outs of coal-fired capacity, promotes improving efficiency with capital investment to keep coal plants running. The plan will never adequately address the Supreme Court’s ruling that CO_2 must be regulated as a pollutant, but is likely to put in place a frustration any Federal efforts to accelerate coal retirements.
- Trump’s U.S. Federal Energy Regulatory Commission directed the largest U.S. power grid operator to force state-subsidised solar and wind power resources to raise their market bids late in 2019, in an attempt to increase hours of utilisation from existing fossil resources and reshape the capacity market outcome.

Nonetheless, zero owners of coal plants in the U.S. have undertaken a ‘stay around for longer’ path or upgrade path based on the Affordable Clean Power Plan; indeed one of the largest operators of coal plants in the U.S., Southern Company, has accelerated its plans to retire more coal capacity in order to achieve a 50% reduction in greenhouse gas emissions by 2030, with a new 2050 target of ‘low or no greenhouse gas emissions’. They reported a record low % contribution from coal under 20% in Q2 2020. Some other selected outcomes from these pro-coal policies include:

- 50 coal plants have closed since the 2016 election; dozens more are slated to close in the next 4 years
- Murray Coal, the largest private coal company in American and whose CEO is one of Donald Trump’s largest individual financial donors, filed for bankruptcy in October 2019. The Top 3 coal producers in the U.S. have all filed for bankruptcy once since 2016.
- Output from renewables exceeded coal-fired electricity share in 2019, which has since accelerated during the COVID-19 related downturn
- Employment of coal mining represents about 50,000 today, surprisingly about flat vs 2016

So what gives? Why would an entire industry blow off this President’s stated and enacted measures to such a level? The answer reveals an important truth: capitalism trumps everything when it comes to the real economy. A brutal combination of pure economics for utility conversions towards renewables (helped by ongoing bi-partisan supported subsidies), as well as a rapid private-sector movement towards ESG and climate change sensitivity (by both large industrial customers and large capital allocators/shareholders) have pinned the trend needle into the red.

For as much as Americans may look inward at political outcomes like a Presidential election for signs of investment opportunity and risk or even relevance, the reality is that within an interconnected world, forces outside the politics of whomever controls the U.S. government will continue to exert as large or an even larger influence over time. Part of this relates to the reality that global climate change policies are already synchronising due to achieving necessary change for the highest common denominator market(s) of relevant size.

An example of this relates to the auto industry, who are dealing with increasingly discordant signals of efficiency and emission policies by region (including from within the U.S. itself, such as California). The EU, which represents 10-15% of global auto demand, has pivoted sharply to decarbonised requirements that will see decades of continuous improvements achieved with an end target of complete decarbonisation by 2050. There isn't anyway to productively pivot to those kinds of requirements without scale. That generally requires an overall platform approach, rather than a customised or contoured solutions by market—needed in part to achieve those economies of manufacturing, costs, innovation, and efficiency. And the reality is: the EU is driving that ship and is simply too large a demand market to avoid, as well as home to much of the leading producers and manufacturers in the industry.

Further, the successes of Tesla—the ultimate industry disruptor--are simply impossible to ignore any longer, with each release into the market they continue to find devastating levels of market share penetration (within their categories) and are creating many multiples of value per unit of growth vs peers now. Political views and policies be damned, when the market speaks this loudly to an industry, there is little room for management teams to be persuaded to continue to follow old ways.

Our outlook thus is as follows: we remain fairly bullish on the overall trajectory for many of our core areas of investment within Energy Transition and Renewable Infrastructure. The forces driving the industry are far beyond the short-run political policy outcomes in Washington, are internationally complementary in nature and increasingly commercial in scope and underpinned by economic value creation, increasingly on a pure cost basis.

If anything hinges on the election as regards to the energy sector, we would submit perhaps it will be energy commodity prices. It is likely that Joe Biden and the Democrats would seek to curtail continued growth of hydrocarbon extraction and/or exports from the U.S., and given this is the part of the world enjoying almost all of the global supply growth over the past decade, anything interrupting that trend is likely to exert pressure on the supply side behaviour and outcome. Ironically, an interruption in spending and growth leading to a more structural constraint on supply may influence price dynamics more forcefully and might actually be the tonic needed for an energy industry that has outspent itself into a declining position of profitability and value destruction for shareholders. It's not an obvious call but given the underperformance of the energy industry during the Trump Presidency, it's not an outrageous possibility that things might be rosier than expected with a change in the White House. And if not, we are cautiously optimistic the private market will continue to make its energy transition shifts as it has at an accelerating pace in the next several years.

Thank you for listening.

Thank you for joining us. And stay tuned for our next episode. Have topics you want covered or other feedback to share? Write us at info@ecofininvest.com.