

US environmental future under President Trump

ESG Insight

March 2017

Ausbil Investment
Management Limited
ABN 26 076 316 473
AFSL 229722
Level 27
225 George Street
Sydney NSW 2000
GPO Box 2525
Sydney NSW 2001
Phone 61 2 9259 0200
Fax 61 2 9259 0222

While the world is moving towards a cleaner economy, and we expect continued global regulatory action on climate change, President Trump has been vocal about the deregulation and abolition of “burdensome” government regulations. What might this mean to investors in the short to medium term? Looking at Trump’s cabinet and the Pro-American energy generation theme that it is pushing, energy industries are likely to be early beneficiaries of the deregulation.

The first step in Trump’s plan will likely be reducing funding for the conservation of environmentally sensitive areas, retaining or increasing subsidies to lift the use of fossil fuels, and restricting further climate change research and funding. With this in mind, the new US administration has targeted the following three environmental mainstays; Government organisations, Domestic legislation and the International Paris Agreement.

We will address each item in detail, starting with Government organisations, specifically, the Environmental Protection Agency, the Federal Energy Regulatory Commission and the U.S Department of the Interior.

The Environmental Protection Agency (EPA) is the procurement and execution arm of the US environmental strategy for air and water pollution. It aims to maintain and enforce standards of operation on companies operating in America on issues as diverse as water use, the disposal of toxic waste, vehicle emissions and fishing zones.

President Trump nominated Scott Pruitt, the Attorney General of Oklahoma, to head the EPA and he was duly appointed. Ironically, in his previous roles Pruitt has filed fourteen lawsuits against the EPA over regulations that curb oil and gas emissions, one of which is still pending. Furthermore, he has promised regulatory rollback following his election and his LinkedIn bio states that he is a “leading advocate against the EPA’s activist agenda.”

At Ausbil, we see the regulators as the most vulnerable to the administration, due to their reliance on funding. Given the EPA is the most public of the three institutions, we believe it will continue to be President Trump’s focus for rhetoric and change. We understand Pruitt and the Trump administration plan is to cut the budget for the EPA by US\$2 billion, which represents about one-quarter of its current annual spending. The proposed budget of US\$6.1bn would see 20% of the EPA’s workforce laid off, with staff dropping from 15,000 to 12,000, which will reduce the agency’s impact and efficiency.

The Federal Energy Regulatory Commission (F.E.R.C) is the regulator responsible for the transportation of oil, electricity and natural gas across America. This makes it integral to the ramp up in production and commercialisation of the energy industry. Generally operating with a bipartisan board of five commissioners and with all non-usual decisions requiring a quorum of three, it is currently operating with only two commissioners, both of



whom are Democrats. Commissioner Cheryl LaFleur has recently been named as acting chairman. LaFleur, who spent 20 years in the industry, serving as executive vice president and acting CEO of National Grid (USA), is seen as friendlier to the energy industry than the previous leader, Norman Bay, who was heavy on regulation and prosecution. At Ausbil, we see three Republicans getting placed on the board with one taking the Chair, and we expect this trend of less regulation to continue.

President Trump is pushing to streamline the process to approve transportation pipelines. Despite community push back on environmental grounds, he has green lighted the Keystone XL project which runs from Alberta, Canada to Nebraska, USA. Other than the creation of jobs and the use of American steel, it is unclear the economic gain that will be garnered, but the environmental impact will be high (both in the US and Canada).

The US Department of the Interior is managed by the US Secretary of the Interior and is responsible for the maintenance, management, mining and drilling on roughly 500 million acres of Federal land. President Trump has endorsed Republican representative, Ryan Zinke, an ex-navy seal team 6 commander, as Secretary. Zinke has publicly stated that he is pro domestic deregulated energy production and he has vowed to revisit the Obama Administration’s moratorium on new coal mining leases. We see a scenario where the new Secretary will lease Federal land to oil and gas companies, in return for royalties and fees to cut down on the growing maintenance backlog of approximately US\$12.5bn. Although on record as a fan of Teddy Roosevelt’s conservation efforts in establishing America’s public parks, we suspect Zinke will take a pragmatic approach to leasing.

With regard to the environmental mainstay of Legislative protection; the standing Acts and Plans serve as the judicial standards for environmental regulation. In his ‘An America First Energy Plan’, President Trump specifically targeted the ‘Climate Action Plan’ that was introduced by President Obama as a three pronged approach to counter climate change.

Obama's plan consisted of a reduction in carbon dioxide (CO²) emissions, encouraged the use of alternate power generation and aimed at increasing the study of climate change. The Clean Power Plan aims to set a limit on maximum CO² pollution from coal burning power plants and its end goal is to reduce CO² levels by 32% from 2005 levels, within 25 years.

The two Acts at the forefront of the climate change discussion are the Clean Air Act and the Clean Water Act. The Clean Air Act focuses on regulating greenhouse gas emissions, of which approximately a third is caused by power generation. The Clean Water Act focuses on pollution controls and utilises the Waters of the US (W.O.T.U.S) rule to determine its scope.

Finally, the third mainstay and the poster child for Global Climate change action, the Paris Agreement, aims to cap world temperature increases at 2 degrees celsius higher than pre-industrial levels. It aims to achieve this by carbon output reductions across the globe. It would take the US approximately 4 years to extradite itself from the Paris Agreement. A quick win would be to withdraw from the United Nations Framework Convention on Climate Change (UNFCCC), an international environmental treaty enforced in 1994, as this would allow immediate US departure.

Ausbil sees such a departure from the UNFCCC as unlikely, as the turmoil this would create does not seem to outweigh the nonbinding nature of the Paris Agreement and the non-ratified status of the Kyoto agreement.

What does this mean for investors?

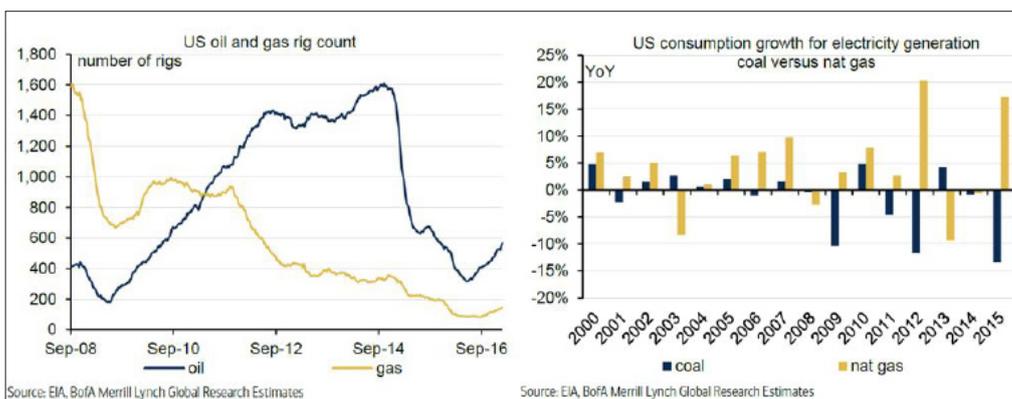
While we expect global action on climate change to continue, Ausbil expects President Trump's team to reinvigorate the American energy industry through a relaxation of the regulation surrounding oil and gas producers. The generation and transportation of new

oil and gas flows will be assisted by the moves taken in the EPA, F.E.R.C and the Department of Interior. We see the larger oil and gas players being slower to move on the new standards due to public relations ramifications and the mismatch between the life of the projects and the sustainability of the rulings.

If economically viable, however, we would not be surprised to see smaller shale companies jumping into contracts on Federal land and risking the longer term implications. These changes, combined with a supportive oil price, will provide an ongoing tailwind to the uptick of oil and gas rig counts. Once entrenched, with licensing fees paid, it would be unrealistic to expect producers to move out. We also see it being unlikely that the next government would pay back licensing fees, resulting in long term positive supply ramifications. As a result, if these changes go through, we see a combined positive impact on the long term supply outlook for the US market. It's worth highlighting, however, that the outright wellhead price, cost inflation and basin location remain higher order drivers for the energy sector than changes to Government regulations.

Another avenue for change highlighted in the America First Energy Plan is the clipping or abolishment of the Clean Power Plan. By decreasing the regulation around power generation, it could further spark a reversal in the transfer to gas. As previously stated, however, due to the long life of coal plants, it seems unlikely that long term plans would be made on the somewhat contradictory ruling of the current President.

A key ESG risk is that the industry does not become more focussed on self-regulation. As such, we would like to see industry responsibility as companies are encouraged to pursue increased production and increased energy self-sufficiency while operating under a potentially less onerous regulatory environment.



Ausbil does not believe the recent developments in the US will derail the Paris Agreement and, as discussed in the paper 'What does the Paris Climate Change deal mean to investors' (published 22 December, 2015), a key global challenge remains to generate electricity for the approximate one billion people in the world that are currently without electricity, while not increasing greenhouse gas emissions. We continue to believe that this means a long-term challenge for the viability of certain fossil fuels.

The information contained in this document is given by Ausbil Investment Management Limited (Ausbil) and has been prepared for general use only and does not take into account your personal investment objectives, financial situation or particular needs. The information provided by Ausbil has been done so in good faith and has been derived from sources believed to be accurate at the time of compilation. While every care has been taken in preparing this information, except as required by law, Ausbil makes no representation or warranty as to the accuracy or completeness of the information provided in this document, or takes any responsibility for any loss or damage suffered as a result of any omission, inadequacy or inaccuracy. Changes in circumstances after the date of publication may impact on the accuracy of the information. Ausbil accepts no responsibility for investment decisions or any other actions taken by any person on the basis of the information included. Past performance is not a reliable indicator of future performance. Ausbil does not guarantee the performance of any Fund, the repayment of capital or any particular rate of return. The performance of any Fund depends on the performance of its underlying investments which can fall as well as rise and can result in both capital losses and gains.

This document is provided to on a confidential basis and the information contained in it must be kept confidential and may not be reproduced or redistributed (in whole or in part) without the express written consent of Ausbil. By accepting a copy of this document, you agree to be bound by the limitations, terms and conditions set out in this disclaimer.

For further information please contact



Nicholas Varcoe,
ESG Analyst
on 02 9259 0276



Måns Carlsson-Sweeny,
Head of ESG Research
on 02 9259 0262

Ausbil Investment Management Limited
ABN 26 076 316 473
AFSL 229722
Level 27
225 George Street
Sydney NSW 2000
GPO Box 2525
Sydney NSW 2001
Phone 61 2 9259 0200
Fax 61 2 9259 0222