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TRANSCRIPT

ESG Now Podcast

“Environment, Climate, Companies and Society / Human Capital”

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Mike Disabato:

There's been 238 ESG Now episodes on everything we can think of and when we're done with them, we have to move on. It's the nature of the audio format, but the stories are not set in time. They continue on and grow and change and insert high pollutant language here about life's movements. And not only that, but my colleagues that I speak to about these stories, they use them to inform their research even as I move on from them and they continue to watch them and they continue to grow with them. Sure. I thought for today, for episode 239, it would be good if we returned to some of the stories that we've spoken about already and see how they have developed since we last discussed them. There was the Adani Group that had a short sell report that questioned their company governance and led to a massive loss in market share.

There's the United Auto Workers Strike and that continuation, the Inflation Reduction Act and where some of that money that's been promised has gone to already, what the EPA's methane rule has done for the gas industry in the US and the ExxonMobil board takeover by Engine No. 1. Now, it wasn't a takeover, it was just three seats on a 12 member board, but still it was a major win for an activist investor worried about carbon emissions at the time. So where is Exxon now in preparing for a climate changed future? So all these stories will be returned to on this episode of ESG Now, where we cover how the environment, our society, and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato. Thank you for joining us. Stay tuned.

The Adani Group was rising along with India's economy, but then in early 2023, a little known US short-seller, perhaps aptly named Hindenburg, released a report that accused the group of some pretty damaging business practices. Adani said the report was bogus. The market reacted anyway and thus began Adani struggled to manage the downfall and the lost investor confidence most prominently seen in its stock price decline. So it's been some time since early 2023, these seven publicly traded companies that makes up Adani Group has worked to regroup. So how have they changed? I asked my governance specialist colleague Harlan Tufford to take me through it.

Harlan Tufford:

So one of the biggest concerns raised in the Hindenburg case was a Donny's choice of auditor. And the different entities in the Adani Group use different auditors. The largest Adani company, Adani Enterprises uses a firm called Shah Dhandharia. And this firm doesn't audit any other companies outside of the Adani Group in our ESG coverage universe. It's very small and Hindenburg raised concerns both about its appropriateness relative to the size of Adani and its independence given its likely dependence on fees from the Adani engagement. What's happened in the month since for Adani? Nothing. It's kept that auditor and it still appears to be Adani Enterprise's auditor as far as we can tell. Elsewhere in the Adani Group, we're actually seeing a trend toward smaller auditors than the company was using before the Hindenberg report. Deloitte in August resigned as auditor of Adani Ports & Special Economic Zone where it had been serving since '17.

It was replaced by a BDO affiliate outside of The Big Four. In the UK, Adani Energy Holdings Limited, which is a subsidiary of Adani Green Energy Limited, announced that it had switched from Crowe UK already one of the smaller UK auditors in our public company coverage universe to Ferguson Maidment and Company, a firm with four partners that audits no public companies in our coverage. And Deloitte also ceased to be auditor of Adani Transmission at its 2023 AGM and Deloitte was replaced by Walker Chandiok & Company, an Indian affiliate of Grant Thornton. So the takeaway is that across the Adani Group, we're actually seeing a move away from larger auditors and towards smaller auditors, which in itself is not necessarily a bad thing, but in the context of concerns about the appropriateness of these auditors and their capacity for an organization with a lot of very complicated related party transactions, it does raise some questions I think for investors.

Mike Disabato:

Harlan Tufford discussing how Adani has adapted to its short-seller report, accusing it in part of not having a quality audit system in place. We move now to a story on the United Auto Workers continued strikes at the big three automakers in the US, General Motors, Ford and Stellantis, the parent company of Chrysler. Now I know it's only been a month since we covered the story, so it must be fresh in your mind oh, kind listener. But a strike is a fast moving event and changes happen quickly. So I decided we better check up on the beleaguered auto industry in the US by calling up our auto specialist, Yu Ishihara, and getting him to tell us about how the strike is proceeding.

Yu Ishihara:

So it's been just over a month since the UAW launched their strike against Detroit Three, and obviously since it's still ongoing, we're yet to see a full resolution. And so you can imagine this has been a pretty taxing environment for the Detroit Three automakers who've all seen more production plants and even service parts and distribution centers being shut down due to striking workers. And the ripple effect of that is also now layoffs not only at the Detroit Three, which have each laid off hundreds of workers, but with idle plants, the effects are also being felt throughout the supply chain as well. So you can imagine the stakes and costs from both sides continue to mount, and at times the rhetoric has seemingly got quite ugly from both sides. But nevertheless, both sides appear to have presented different versions of contract offers with the OEMs seeding things like wage increases to the tune of 20% or more and potentially other concessions that the UAW were asking for according to the media.

But as we spoke about last time, this whole situation isn't just about wages and benefits and working conditions, it's really about the just transition for UAW workers in the electric vehicle era. And so to that end, the sticking point in the negotiations has always been union influence over the many EV battery plants that are now being built by the Detroit Three. Actually, there have been some recent developments where the UAW announced that GM had actually agreed to let the union organize its battery plants. So this is arguably a huge win for the UAW, which could potentially secure outlets for displaced combustion engine factory workers into these battery plants in the future. But at the same time, unionized workers at battery facilities could potentially mean higher cost structures for the OEMs, which ultimately either be passed on to the consumers making EVs built with union made batteries potentially more expensive.

They could just eat into the margins of the automakers themselves. So this is also why despite GM supposedly making these concessions, Ford seems to be holding a pretty hard stance against allowing unions into the battery plants. And it's important to bear in mind most of the competition, including foreign automakers and even Tesla are mostly non-union. And while I certainly understand why a just transition is honorable demand from the UAW perspective, operating multi-billion dollar battery plants with a structural cost benefits advantage is a tough bill to swallow for the Detroit Three who are looking to make the green transition whilst continuing to be competitive.

Mike Disabato:

Yu Ishihara on the striking auto workers and the big three auto companies in the US. One of the main issues the UAW was dealing with was the auto industry's transition to the electric vehicle. A transition pushed along by provisions that support the transition to EVs and the Inflation Reduction Act of the IRA. We covered the tenants of the IRA back in August 2022 when it was passed by the US Senate and at the time it was promised to usher in a new era of US investment and low carbon infrastructure. We quoted the people at Princeton's Zero lab to defend this who said that the IRA could drive nearly 3.5 trillion US dollars in cumulative capital investments into the new American supply infrastructure over the next decade. So it's been a year of that decade and it's time to see if the sort of money and propositions pose in the IRA have materialized in any way. So Matthew Lee, one of our sector experts, I called him up and he told me about where we are with the promises made in the IRA.

Matthew Lee:

So one year in, there's not a lot of raw spending numbers yet simply because this has been a ramp up period of guidance being clarified and the various agencies that are getting IRA funding releasing more details about how they will disperse their funding. I think it's helpful to take a step back to see how it fits in the bigger picture of the US' industrial policy ambitions around clean energy. Don't forget, the IRA is actually the third in a series of legislation, so the Bipartisan Infrastructure Bill and the CHIPS Act are already touching on the same topic. And so what we see here is how the IRA works in concert with some of these other bills. For example, the Department of Energy has just released its first slate of hydrogen hubs that it's rewarded. So funding to develop new clean hydrogen areas and demonstration projects.

The grants are for constructing and building up the infrastructure for some of these hubs. But the IRA, the tax credits of per unit of hydrogen generated factor heavily into the project economics and attract companies and investors alike to submit proposals and have more buy-in into this clean hydrogen infrastructure they want to build in the US. In the longer term, the power sector is looking quite different in 2035 as a result of the IRA, we're looking at potentially two thirds to almost 87% of all power generation in the US by 2035 being from low or no carbon sources, and that's up from around 40% today what it's at.

So that's a pretty significant increase that we expect to see facilitated by the IRA, but in the short term, there are some pretty significant headwinds that do need to be overcome. We've already seen supply chain costs and high rates of inflation lead to delayed wind projects or even canceled wind projects, large offshore wind bids in the US as well as continued stress on the grid in terms of slower than expected transmission distribution build out and permitting issues may prevent in the short term deployment from happening as quickly as people want to see it.

Mike Disabato:

Matthew Lee from our energy sector team talking about the IRA. And what is interesting about the IRA is it is sort of an umbrella regulation at this point where it covers almost all carbon emissions regulations in the US in its shadow. For example, in late 2022, we talked about this US EPA rule that aimed at plugging persistent methane emissions, methane being a greenhouse gas that is 25 times more potent than carbon dioxide at trapping heat in the atmosphere. And there are methane leaks all over the world, which is a huge problem for our emissions reduction plans. So the IRA introduced a further push for the EPA methane regulation by imposing a methane penalty fee on oil and gas companies whenever leaks were found. So where are those rules and regulations now, both EPAs and the IRAs? I turned to my colleague Chris Cote, so he could answer that very question for me.

Chris Cote:

So like with many other things in climate change action in the United States, the Inflation Reduction Act is what happened. I think we're going to see next year, 2024, I think finally be the year where we can point to companies taking strong action on methane in the US at least and maybe globally. In the US it's pretty simple. The government has started to price in the cost of methane for these companies. The Inflation Reduction Act has put a price on methane. If you convert it not to methane, but to its CO2 equivalent, this is going to start out at $36 a ton. So there's basically a carbon price on methane starting next year for oil and gas producers, and that's going to gradually escalate up to $60 a ton by 2026. So companies now have a really obvious incentive to reduce their methane emissions, which as we discussed last time isn't really that big of a cost for them anyway.

And in addition, the government's also providing financial incentives, carrots not just sticks, where there's a pool of money for helping you with your methane reporting, installing and upgrading equipment as well. So the government's making it easier for these companies to change their practices. And then there's also a global story here. So I think we've been watching for the last couple of years, the development of what was originally this EU focused initiative called the Oil and Gas Methane Partnership 2.0. That's now expanded. There's over a hundred companies involved in it and a bunch of NGOs helping to run it, EDF and others. And it comes with an intensity pledge for companies to reduce their methane emissions and also helps provide a lot of technical guidance and the kind of things like that. I think the momentum that's been behind the oil and gas methane partnership is flowing into COP 28 this year in the UAE.

So in the United Arab Emirates, we're going to see oil and gas companies pledge to take action. And I think underlying that is the groundwork we've been following over the last two years, having companies understand better what their options are. The more and more companies we talk to are already getting drones out into the field. They're increasing their continuous monitoring practices. The big companies are taking this seriously, and I think what the sticks from the Inflation Reduction Act, the EPA and others are going to have follow on, is to get those laggards to really come into line and take this seriously as well.

Mike Disabato:

Chris Cote, who was on our energy team talking about methane regulations. Back in May 2021, a strange bedfellow came into the fold at ExxonMobil. It was a little known activist hedge fund investor called Engine No. 1. Now, Engine No. 1 won a proxy battle with Exxon after it received big institutional backing in its request that Exxon diversified away from fossil fuels and reduced its carbon emissions. That's what it ran on at this proxy vote. And so Engine No. 1 got three board seats on Exxon's board because of its victory. And the talk at the time was that Exxon might change how it invested in fossil fuels due to these new board members' influence because these board members wanted to transition Exxon away from fossil fuels and lower its emissions. We talked about it when it happened and it's been two years in change. So where are we now with Exxon? I called up my colleague who covers the energy sector for us, Antonios Panagiotopoulos, and put the question to him as Exxon moved away from fossil fuels and thus lowered their carbon emissions.

Antonios Panagiotopoulos:

I think at least on paper, the opposite. At least we haven't seen much of a change in the direction of Exxon. Actually in the last week, we've had the announcement that they will probably... they entered an agreement to buy Pioneer Natural Resources. Pioneer Natural Resources is a company that is operating in the Permian Basin. The two companies will have an estimated 16 billion barrels of oil equivalent resources in the Permian Basin, and that should more than double the production of action to around 1.3 million barrels per day. So it is quite an important acquisition.

Having said that, also we need to add another acquisition from Exxon that was announced earlier in the summer of Denbury Resources. Denbury Resources is a company that essentially is an experienced

developer of carbon capture and storage solutions and enhanced oil recovery. So there is a possibility that all this kind of signifies Exxon's one goal to be probably the biggest oil producer definitely in the US, the biggest developer of shale oil and gas in the Permian, but also with that scale, potentially develop certain carbon capture and storage solutions.

Mike Disabato:

Antonios Panagiotopoulos talking about where Exxon has been since losing board seats to an activist investor that has added climate concern. I'll just make an ending statement there on that story from Antonios. It's interesting because Exxon seems to at least be investing in the carbon capture side that they sort of implicitly promised to move toward with this appointment with the board members that had climate concerns. So again, this is a story that we're going to have to watch. We're going to see how Exxon has to move, but it's sort of like it's trying to have its cake and eat it too. There's a contradiction there.

So these stories are complex. They have a lot of moving parts. We'll try to return to them as much as possible. But I appreciate you walking down some nostalgia and learning some new things with me today. Thanks for listening. I wanted to thank my colleagues, Harlan, Antonios, Matthew, and Chris for talking to me about the news with an ESG twist. I wanted to thank you so much for listening. If you liked what you heard, don't forget to rate and review us. That really helps. And if you want to hear myself or any of the other wonderful ESG Now podcasts in your earballs every week, then subscribe. Thanks again and talk to you soon.

Speaker 7:

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