

Perspective on the Energy Transition

► As the world moves towards renewables, traditional energy still serves a purpose



Investing in the oil and gas industry has become one of the most contentious topics in the ESG (environmental, social, and governance) world. Certain investors associate investment in the traditional energy sector as being counterintuitive to global decarbonization efforts. Yet as is often the case with ESG issues, the energy transition towards renewable energy is more complex and nuanced than it appears on the surface.

Summary

- A shift away from fossil fuels towards renewable energy is vital in keeping global warming to 1.5 degree Celsius, but it will take decades for renewable energy to become the dominant source of energy.
- There are several obstacles that prevent the ability to ramp up renewable energy capacity globally, including the material-intensive nature of building wind turbines and solar panels, the time-consuming logistics to building new infrastructure for renewable energy, as well as the need to solve technological limitations.
- In the meantime, without sufficient renewable energy capacity to take over, a premature phase-out of fossil fuels could generate negative consequences like energy shortages, higher prices and adverse economic impacts – all of which disproportionately impact the lower-income cohorts.
- Within the context of achieving a responsible energy transition, we believe the traditional energy sector has a crucial role to play by supporting the consumer's need for affordable and reliable energy.

The energy transition is complex and challenging

Climate change is one of the most significant crises of our time. A shift away from fossil fuels – which includes coal, crude oil and natural gas – towards renewable energy is vital to achieving the Paris Agreement goal of keeping global warming to 1.5 degree Celsius and averting the worst effects of climate change. The necessity and urgency of the energy transition is widely accepted, but there is a lack of consensus on a reasonable timeframe and the challenges are not widely understood.

The growing rate of renewable energy adoption has been encouraging over the last few years, but the reality is that it will take decades for renewable energy to become the dominant source of energy. In 2021, renewable energy (i.e. wind and solar) represented about 13% of the global energy supply, which pales in comparison to the 82% coming from fossil fuels.^{1,2} There are several obstacles that prevent our ability to ramp up renewable energy capacity.

The first is the material and intensive nature of building wind turbines and solar panels. Compared to a traditional gas-fired plant, an offshore wind plant requires thirteen times more mineral resources and a solar plant requires six times more.³ Shifting the energy supply to renewables means there will need to be a substantial increase in commodities like copper, zinc, silicon and lithium, which we do not have today. At the same time, the mining process for these commodities, many of which are located in countries with poor governance practices, may take many years to go through the stages of exploration, development and extraction.

Another hurdle is infrastructure. Most of the existing transmission infrastructure, like power lines, were built to serve fossil fuel and nuclear power and, as a result, new infrastructure is needed to transmit solar and wind energy. Intermittency and storage are another challenge – the wind does not always blow, nor is it always sunny, and current battery technology is not adequate enough to allow for a complete reliance on wind and solar as baseload power. Wind turbines and solar farms also require land to be built upon, which requires time for negotiations, permits and community considerations.

These factors help illustrate that the energy transition will not happen overnight, and it will likely take decades before renewable energy can feasibly surpass fossil fuel energy.

With this in mind, by providing affordable and reliable energy, fossil fuels and natural gas in particular (because of its lower emissions compared to coal), have a role to play in the global energy transition. Without a sufficient supply of renewable energy, a premature phase-out of fossil fuels could result in significant unintended repercussions such as energy shortages, higher prices and an adverse economic impact – all of which would disproportionately impact the lower-income cohorts.

The current energy crisis in many European countries is an illustration of this quagmire. In 2021, Russia supplied 32% of Europe's gas, whilst sending half of its oil exports to Europe.⁴ Following Russia's invasion of Ukraine, European policymakers are attempting to reduce their reliance on Russian oil and gas, but lack a clear substitute to replace it. These events have caused global oil and gas prices to rise drastically, and everyday consumers have felt the immediate effects at the pumps via higher gasoline prices. All this is forecast to lead to a significant surge in gas and electricity prices in the UK come wintertime.⁵ It seems likely that many European countries will look towards boosting their use of coal – a higher carbon-emitting fuel source than oil and gas – to help cope with the looming energy shortage.⁶

Recognizing the need for affordability and reliable energy, we have started to see a shift in thinking about the role of oil and gas in the energy transition and the decarbonization of the global economy, and with that, its place in investment portfolios. Views on the energy transition have generally differed geographically, with European investors leading the charge by divesting from energy companies, while investors in North America are more likely to acknowledge the need for oil and gas. Even so, it is worth noting that holdings in energy companies have risen modestly in European ESG Funds this year, when they were once shunned by European investors, as reported by the Financial Times.⁷

Guardian Capital LP's Approach

We believe the traditional energy sector has a crucial role to play in the energy transition by supporting the need for affordable and reliable energy.

Not all energy companies are created equal and, as with any industry, there are always leaders and laggards when it comes to sustainability practices. Guardian Capital's highly experienced investment teams conduct holistic ESG-related assessments on the individual companies in their portfolios as a part of the investment process. Our approach is to understand the environment in which these companies operate and assess the impact that ESG factors have on a company's valuation and outlook. Leaders in the energy space tend to be proactive in addressing ESG issues in a variety of ways, including seeking to reduce the carbon intensity and air pollution impact of their operations through technological and process improvements, reducing and recycling hazardous waste streams, integrating community engagement into each phase of the project cycle, protecting the health and safety of all employees and developing a culture of safety to reduce the probability that accidents will occur.

At Guardian Capital, we believe that oil and gas companies, with their long operating history and strong research and development (R&D) track record, are well placed to further develop existing technologies essential to reaching net zero goals like carbon capture and storage technology. In addition, they can invest in and advance R&D on new technologies and solutions like hydrogen or small modular nuclear reactors, as well as emerging technologies like direct air capture. For this reason, we expect to remain long-term investors in this sector.

Additionally, Guardian Capital's fundamental equity managers engage with oil and gas companies on topics such as GHG emissions, resource and waste management, environmental impact and goals, as well as plans to mitigate climate change-related risks. Corporate engagement has become common practice among institutional investors and involves undertaking a series of meetings with corporate leaders to understand and question current practices and to drive positive change. We are committed to using our powers as a shareholder to influence companies to improve sustainability practices and corporate behavior.

¹BP p.l.c., Statistical Review of World Energy 2022, 71st Edition, published in 2022. <https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html>.

²The remaining 4% difference comes from nuclear energy.

³International Energy Programme, Minerals used in clean energy technologies compared to other power generation sources, IEA, Paris, last updated May 5, 2021. <https://www.iea.org/data-and-statistics/charts/minerals-used-in-clean-energy-technologies-compared-to-other-power-generation-sources>.

⁴International Energy Programme, Frequently Asked Questions on Energy Security, IEA Article, Paris, June 16, 2022. <https://www.iea.org/articles/frequently-asked-questions-on-energy-security>.

⁵BBC News, Warning winter energy bills to rise by more than expected, Business, by Noor Nanji, August 2, 2022. <https://www.bbc.com/news/business-62380728>.

⁶Bloomberg, Europe Snaps Up Coal From Abroad to Fill Gap Left by Russia, Green, New Energy, by Serene Cheong and Ann Koh, July 5, 2022. <https://www.bloomberg.com/news/articles/2022-07-05/coal-imports-pour-into-energy-starved-europe-from-around-globe>.

⁷Financial Times, Energy crisis prompts ESG rethink on oil and gas, Special Report Sustainable Finance, by Chris Flood, July 18, 2022. <https://www.ft.com/content/c45692c7-8695-438d-9414-33137be91e79?>

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