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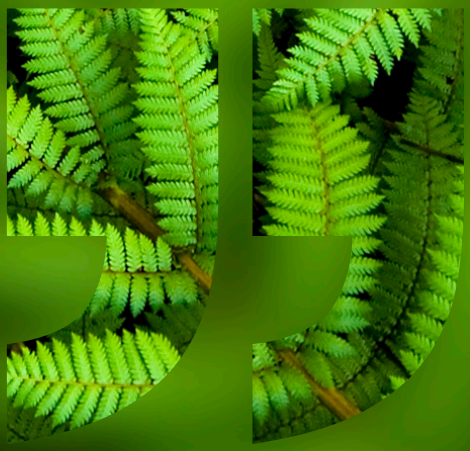
CLIMATE CHANGE AND THE PRESSURE ON COAL – LATEST DEVELOPMENTS



– THOUGHT LEADERSHIP

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CLIMATE CHANGE AND THE PRESSURE ON COAL – LATEST DEVELOPMENTS

Coal projects are under pressure from governments, courts, businesses and investors as the momentum to reduce the use of coal builds. This briefing explores some of the action being taken by the public and private sectors and the impact on the industry.

Coal – key issues

- Coal use is declining in developed countries due to lower cost, and cleaner, alternatives and environmental policies.
- Courts and decision-makers are starting to take an interventionist approach in blocking coal projects.
- Political pressure against coal projects is growing with some developed countries putting in place coal bans.
- Private sector action is also increasing, fuelled by investor concern, CSR and ESG commitments and supply chain pressure.
- Coal is still a key fuel in countries with developing economies driven by lower costs and support for national coal industries, but these drivers may change.
- Technological questions still remain over a move to cleaner alternatives including the role of carbon capture and alternatives to coal in the steel industry.

Coal powered the industrial revolution and remains a key fuel source powering growth in nations such as China and India. However, continued high demand for coal across Asia – both for power and industrial processes such as steel production – contrasts with rapidly declining coal use across much of the developed world. With the Paris Agreement's objective of limiting the increase in global temperatures to 2°C above pre-industrial levels, calls to reduce coal use have been growing steadily.

Coal use has been on the decline in developed countries over the last two decades as the combination of aged coal plant, increasingly cost-competitive alternatives and environmental imperatives has led an increasing number of countries to favour cleaner, and lower carbon, energy generation. The huge global growth of renewable generation, alongside the adoption of policies to phase out all coal generation in countries like Germany and UK, epitomise this change. Although the International Energy Agency predicts only a 2% decline by 2023 in coal's contribution to the total global energy mix (from 27% to 25%), the change has and will be significantly more dramatic across Europe where the European Electricity Sector Association (Eurelectric) has pledged on behalf of its members (other than in Poland and Greece) not to build any further coal plants after 2020.

Intervention by Courts/ decision-makers on coal projects

National courts and decision makers are starting to rely on climate change as a ground for stopping coal extraction projects. Most recently in February 2019, the New South Wales Land and Environment Court refused approval for a new open cast mine in New South Wales, Australia, called the Rocky Hill Coal Project. This landmark judgement cited traditional zoning, visual and amenity impacts as sufficient grounds for refusal of the appeal, but critically the judge also cited the likely contribution of extracted coal to the adverse impacts on the climate system as a further reason for refusal. In a decision which analysed climate issues in depth, the judge decided that he should take into account in his determination not only the direct emissions of extraction (e.g. fugitive methane emissions), but also so-called scope 2 and scope 3 emissions caused by combustion of coal down the supply chain. Given the central role of coal in the mining sector in Australia, it is unsurprising that this judgement has proved highly controversial, with domestic commentators claiming that it will have far-reaching consequences for other fossil fuel projects. We understand that a further notice of intention to appeal has been lodged and the world will be keenly watching how this case progresses.

This judgement followed a similar case in the UK in 2018 in which the UK Secretary of State for Communities and Local Government rejected planning approval for an open cast mine in England. The decision was based upon UK planning policy which requires that permission for extraction of coal should not normally be given unless the proposal is environmentally acceptable or can be made so; or failing that if the benefits of extraction clearly outweigh the adverse impacts. The Secretary of State decided that the significant impact caused by greenhouse gas (GHG) emissions and on climate change were factors that needed to be considered, and that the balance ultimately tilted towards rejecting the scheme. The decision was later quashed on procedural grounds and is now subject to an appeal to the UK Court of Appeal – their decision will be watched very closely by industry.

In the United States, reflecting the currently divergent views between many state and federal authorities, there are several pending cases that challenge approvals or denials of specific coal-related projects. At the federal level, several environmental advocacy groups have sued the US Department of the Interior to stop the expansion of the Bull Mountains coal mine in Montana. At state level, the developer of a coal export terminal sued the Washington State Department of Ecology, alleging that it improperly denied approval for the coal export terminal due to concerns with the environmental impact of coal. Both cases remain pending, so we will have to wait to see whether and how far the courts will act as a check on the Trump administration's ambitions for the US coal sector.

It remains to be seen whether cases such as these will provide impetus for other country's courts and decision-makers to take into account climate impact in planning and related approvals relating to, *inter alia,* future coal and coal power projects. Doubtless, domestic energy needs, economics and employment will remain factors that will weigh heavily in such decisions, but the increased willingness of courts to require direct and indirect climate change impacts to be taken into account is potentially very significant

Political pressure on coal

In November 2017, an alliance of national and sub-national governments, businesses and organisations signed a declaration on ending coal-fired power generation by 2030 in the EU and OECD countries, and by 2050 elsewhere. Signatories to this Powering Past Coal Alliance Declaration proposed the phasing out of traditional coal power generation and a moratorium on all new coal plant without Carbon Capture and Storage (CCS). This Alliance has grown from an initial 20 members to 80 as of December 2018, including 30 national governments (See table below).

Powering Past Coal Alliance members as at December 2018	
National Governments	Austria, Angola, Belgium, Canada, Costa Rica, Denmark, El Salvador, Ethiopia, Fiji, Finland, France, Ireland, Israel, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Marshall Islands, Mexico, Netherlands, New Zealand, Niue, Portugal, Senegal, Sweden, Switzerland, Tuvalu, Vanuatu, United Kingdom
Sub-national Governments	Australian Capital Territory Australian cities: Melbourne, Sydney Canadian Provinces: Alberta, British Columbia, Ontario, Quebec, Vancouver US States: California, Connecticut, Hawaii, Minnesota, New York, Oregon, Washington US Cities: Honolulu, Los Angeles Government of the Balearic Islands, Spain South Chungcheong Province (South Korea) City of Rotterdam, Netherlands Scottish and Welsh Governments
Businesses and Organisations	Alterra Power Corp., ArcTern Ventures, Autodesk, Avant Garde Innovations, BT, CCLA Investment Management Limited, Diageo, Drax, DSM, Econet Group, EcoSmart, Electricité de France (EDF), Engie, GeoExchange Coalition, GreenScience, Iberdrola, Kering, Marks and Spencer, Natura Cosmetics, Ørsted, Pacific Islands Development Forum, Salesforce, Scottish Power, SSE, Storebrand, Unilever, Virgin Group, XPND Capital

Commitments under the Paris Agreement are contributing to a number of countries' decisions (mainly in Western Europe) to move away from coal in a transition to a low carbon economy, but in a way that suits the national context. Examples are:

- **Germany:** The German Coal Commission voted in January 2019, subject to Government approval, to prohibit coal-fired power generation by 2038 at the latest (and possibly by 2035). This would be a bold and historic move for Germany which has a large coal industry, and comes despite the pledge to also phase out nuclear power generation following the Fukushima disaster. It remains to be seen whether the Government is prepared to pay the large compensation bill to close these plants down and whether coal-producing regions will further support this move.

- **The Netherlands:** Legislation which would set a phased close-down of coal-fired plants between 2025 and 2030 is currently being debated, driven by the Netherlands' national target to reduce domestic CO2 emissions by 49% by 2030 (against 1990 levels). In October 2018, the Dutch Court of Appeal upheld a decision that the state must reduce emissions by at least 25% by 2020. This decision has already led to a Government decision to close a coal-fired power station in Amsterdam (Hemwegcentrale) by 31 December 2019, and is likely to lead to the wider closure timetable being accelerated.

- **UK:** The world's first coal power plant opened in London in 1882, but today the UK Government is committed to ending coal-fired generation (unless developed with carbon capture, use and storage (CCUS)) by 2025. This is to be achieved by imposing CO2 emissions limits on power generation units. The UK's support for CCUS was initially strong, with the UK government seeking to promote UK leadership in the technology with a £1bn subsidy to develop a commercial scale CCUS plant. However, the subsidy was cancelled as part of wider budget cuts, leaving development of CCUS in the UK with little substantive government support.

Elsewhere, coal remains key to many national economies.

Australia's energy policy has been subject to much politicking in recent years. The current federal (coalition) Government has been a vocal supporter of investment in new coal power stations. However, in March 2019 the Prime Minster released a shortlist of 12 baseload projects across Australia that the federal government could underwrite as part of its strategy to increase competition in the generation sector, and just one of these involved coal. The others were gas-fired and pumped hydro projects. The opposition Labour party is also threatening to ban the federal government from funding new coal investments if they come into power. A federal election is set to take place on 18 May 2019 and so Australia's energy policy may remain in a state of flux this year.

In the US, coal-fired power generation has been declining in recent years, but this is largely due to other cheaper sources of energy (natural gas and renewable energy) undercutting coal prices, as well as air quality issues. While the current US Administration has been strongly supportive of the US coal industry and stated an intention to pull out of the Paris Agreement, signs of a new green movement may be emerging. Twenty-two US states (and one territory) have committed to upholding the objectives of the 2015 Paris Agreement and have followed these commitments with action. In May 2018, Governor Andrew Cuomo of New York announced regulations that would end coal use in New York state by 2020. In January 2019, he also announced a "Green New Deal," which mandates 100% clean energy in New York state by 2040. The US House of Representatives has also reinstated the Select Committee on the Climate Crisis, which will focus on global warming "from the standpoint of health, security, economics and morality." The debate generated by Alexandria Ocasio-Cortez's Green New Deal, which

proposes a comprehensive plan to address US climate change and stimulate the economy, may push climate change issues to the fore in the 2020 Presidential election.

The importance of coal as a major power generation source for countries with developing economies is unlikely to diminish for the foreseeable future where coal is seen as a cheap energy source powering industrialisation. However, the coming years are likely to see the drivers to reduce coal use increasing. These may be directly as a result of climate commitments, but are equally likely to result from increasingly stringent environmental policies to control air pollution (e.g. in China), as well as the improving economics of natural gas and renewable power generation (e.g. in India).

The private sector

In addition to independent action taken by utilities (notably the restructuring of E.ON and Innogy in Germany), and pressures exerted by NGOs and government policy, individual investors and investor groups (such as Climate 100+ and the Institutional Investors Group on Climate Change, IIGCC) have led calls for mining companies to move away from coal extraction and for utilities to make coal-fired power generation a thing of the past. Following the conclusion of the latest Climate Conference in Katowice, Poland, investors with over USD11 trillion under management urged power generators to eliminate coal use by 2030. How coal-reliant organisations will manage future stranded assets resulting from the inevitable (and possibly rapid) exit from coal is of particular concern to these investors.

The UK Church of England (through its Church Commissioners, a Climate 100+ investor) led action urging Australia-based mining and commodities company Glencore to limit its coal production. This led to Glencore pledging in February 2019 to cap its coal production at around 150 million tonnes of coal per year. This follows Rio Tinto's 2018 decision to exit coal completely, selling its remaining coal mine interests.

In February 2019, the Global Investor Coalition on Climate Change (GICCC, formed of four investor groups including IIGCC) turned its sights to the steel producing industry, announcing its expectations that steel companies set goals and transition plans consistent with Paris Agreement targets. A key aspect of those transition plans is likely to be a move away from use of coking coal in the manufacturing process to other alternatives, e.g. hydrogen, although this technology has not yet been fully commercialised.

Adding to this pressure is the position taken by increasing numbers of banks and insurance companies who are refusing to provide finance or insurance cover for coal extraction or coal-fired power generation. Allianz, for example, decided to stop offering insurance to planned and existing coal-fired generation plants in May 2018. In December 2018, the European Bank for Reconstruction and Development (EBRD) launched its 5-year strategy announcing its decision to end financing of thermal coal mining or coal-fired power generation; this decision may well have a significant effect on developing regions where coal is still dominant. A combination of corporate social responsibility (CSR) and environmental and social governance (ESG) policies, fear of bad publicity and actual divestment threats are driving banks to address the issue directly, with investors and pressure groups asking banks to lend in a manner consistent with the Paris Agreement. A number of commercial banks have already said they will not provide further coal power funding – there will be continuing pressure on others to follow suit.

A growing number of corporates are taking a strong lead on climate issues also. To give just one prominent recent example, in February 2019 Volkswagen announced that they would give performance ratings to their supply chain based on environmental impact and social responsibility, with those ratings counting in their procurement decisions. Their aim is to produce a carbon neutral vehicle fleet by 2040. Where they are leading, others will surely follow.

What's next?

While coal may still be king in much of the world where industrialisation is key, it is clear that momentum is building in Western economies for a move towards cleaner fuels. This move is being driven from a number of different directions in the public and private spheres. The pressure for change is likely to grow further as the recognition of the need for urgent climate change action intensifies, and as global businesses increasingly seek to distance themselves from activities labelled as 'unsustainable'.

Of course, even in Western economies there are countervailing concerns: a continuing need for cheaper energy often provided by coal; a natural desire to support national coal industries and exports; and fears that low carbon sources will be inadequate to maintain economical and reliable power systems. Questions will also remain over technological development – what role will CCUS play in the continuation of coal use in the power sector and who will fund it? Will alternatives to coking coal prove suitable and economic in the steel sector? However, with the Paris Agreement's 1.5°C and 2°C warming targets in mind, pressure for change is likely to continue from governments, NGOs, the courts, corporates, investors and voters alike.

We produce a wide range of publications and client briefings in relation to renewable energy and green finance. These are available via our intranet page www.cliffordchance.com/briefings.html or contact us if you wish to receive a hard copy.

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