

# ESG Viewpoint

December 2020



## Coal's uncertain future

- With a growing number of governments setting paths to net zero emissions, the future of coal is in question, with estimates that coal use would have to drop by 60% by 2030 to achieve a net zero future.
- We engaged with coal mining and electric utility companies to press for a proactive response to the transition.
- In mining, we found a split between diversified miners, who are moving away from coal at varying speeds, and pureplay miners, who are yet to develop convincing strategies.
- In the electricity sector, a shift is already underway to cleaner energy – but the pace of change is far faster in some countries than others.



**Vicki Bakhshi**  
Director, Responsible  
Investment



**Derek Ip**  
Senior Associate,  
Analyst, Responsible  
Investment

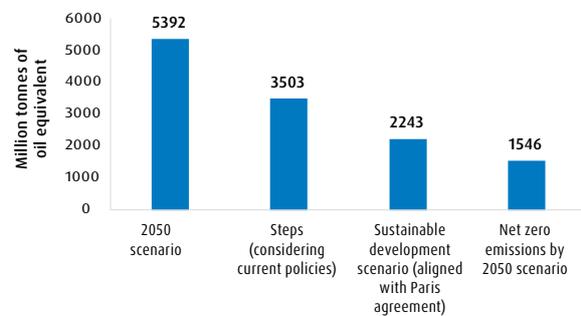


## Overview

With the postponed 2021 COP26 climate negotiations now less than a year away, governments are increasingly setting a course for net zero emissions by mid-century. Europe has a 2050 net zero target<sup>1</sup>, as does Canada. In Asia, South Korea and Japan have done likewise, with China setting a 2060 ambition. US President Elect Joe Biden has made clear his intention to bring the US back into the Paris agreement and set a net zero goal. Meanwhile, many of the world’s largest companies have set equivalent targets.

As the most greenhouse gas intensive of the fossil fuels, there is a now an existential question about the future of coal. Although it still supplies over one-third of the world’s electricity production, Bloomberg New Energy Finance’s [latest analysis](#) suggests that coal demand peaked in 2018. In a scenario assuming net zero emissions by 2050, the International Energy Agency predicts coal demand would fall by 60% between 2019 and 2030<sup>2</sup>. The Powering Past Coal Alliance, established by the UK and Canadian governments, calls for the complete phase-out of coal for power generation by 2030 for developed markets, and 2050 for emerging economies.

### Coal Demand in 2030 Across IEA Scenarios Compared to Current Level



International Energy Agency Scenarios

Source: [International Energy Agency World Energy Outlook 2020](#). All rights reserved by the Agency. Graph reproduced by BMO GAM.

With prospects of a dramatic shrinkage of the coal market, our engagement has sought to encourage companies with exposure to coal to be proactive in how they will manage the transition and avoid the risks of stranded assets.

**Interested in learning more?** Keep on scrolling or click the quick links.

<sup>1</sup> Applies to the UK and all EU countries except Poland

<sup>2</sup> [International Energy Agency \(2020\) World Energy Outlook 2020](#), page 123



## Our engagement approach

We have been engaging companies one-on-one on coal-related risks for some years. In 2020, we launched a more systematic approach, focusing on both the supply side (mining) and demand side (power utilities) in countries we see as pivotal to the transition:

### 15 countries make up of 90% of the world's coal capacity under development<sup>3</sup>.

Our 2020 focus was on thermal coal mined and used for power generation, but we also found space to engage with companies mining metallurgical coal, primarily used for iron & steel production. In this context, we centred our engagement efforts with companies that are:



Multinational miners, who influence global supply



Based in China, the largest coal producer and consumer in the world



Based in the US, where we judged there to be significant scope for engagement progress

We have also engaged selected companies elsewhere in Asia where we see the largest risks, as well as several European power utilities, including through the Climate Action 100+ initiative.

Our view is that European utilities are generally heavily engaged already, and the policy regime in Europe is relatively well-developed compared with many other markets, so we have not made this region our primary target.

“ ”

The world is facing a climate crisis. Waiting for action by governments is not enough – investors and corporates need to take bold and ambitious action.

**Vicki Bakhshi, Director, Responsible Investment**

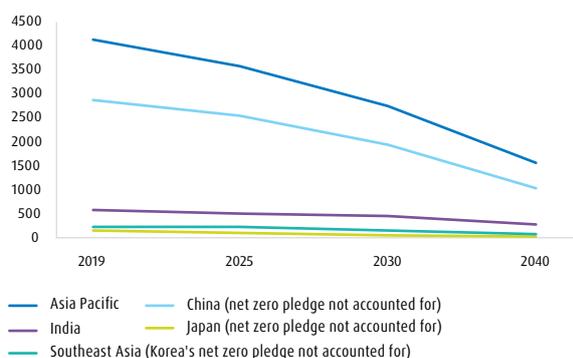
<sup>3</sup> Carbon Brief (2019)



## 2020 engagement with coal mining companies

The coal mining sector is generally not vertically integrated, meaning that companies have little control of the emissions resulting from coal combustion. This limits the options for the sector – in particular for pure-play coal miners – to successfully navigate shrinking demand (see graph below) as electrification and other alternatives take a larger share in the energy system.

### The IEA Sustainable Development Scenario Pathway of Coal Demand in the Last Sizable Market – Asia



Source: [International Energy Agency \(2020\) World Energy Outlook 2020](#). All rights reserved by the Agency. Graph reproduced by BMO GAM.

Whilst the diversified miners may be able to enjoy the long-term demand increase of other metals and minerals, their energy transition journeys are not straightforward.

<sup>4</sup> [Glencore](#) (2017)  
<sup>5</sup> [BHP](#) (2020)  
<sup>6</sup> [Anglo American](#) (2018)  
<sup>7</sup> [Bloomberg](#) (2020)  
<sup>8</sup> [Financial Times](#) (2020)  
<sup>9</sup> [Financial Times](#) (2020)

The competitive commodity markets mean that companies face difficult decisions on the timing of further diversification away from coal. Some are hanging their hopes on ‘clean coal’ technologies, particularly carbon capture and storage (CCS). However, CCS faces significant economic and public acceptability obstacles, and our engagement with electric utilities did not uncover any making serious plans to invest in this technology.

In 2020, we engaged with 3 diversified miners with coal exposure and 3 pure-play coal miners. The diversified miners are naturally more open to our engagement as coal is not the only segment supporting their growth. It was noteworthy that none of the three diversified miners saw an upside on thermal coal demand in the most ambitious climate action scenarios (often referenced as 1.5/ 2-degree compatible) in their current public disclosures<sup>4 5 6</sup>.

All three of the diversified miners we engaged have coal phase-out commitments, but with very different strategies to achieve this. **BHP** and **Anglo American** have indicated that they intend to sell their thermal coal assets in the next few years<sup>7 8</sup>; whilst **Glencore** has decided to run its assets to the end of their life<sup>9</sup>. Whilst Glencore’s approach seems weaker on an individual basis, the fossil fuel divestment route taken by BHP, Anglo and others could actually be little different in achieving real world reductions, as assets that are sold could continue to be operated for many years to come. Whichever approach companies take, we believe that all these commitments are already sending out a strong market signal on the possible future of thermal coal supply.

We also continue to engage with all these miners to ensure a fair transition out of thermal coal for local communities.

## BHP

### – Engaging with customers whilst selling thermal coal assets



We have had more than 10 engagements with BHP in the build-up to its new climate change strategy, announced in September. Alongside the intention to divest or demerge its thermal coal assets, BHP has committed to net zero operational emissions by 2050 through investing in, amongst others, fleet electrification, green hydrogen and carbon offsets. Another key part of the strategy is engagement with customers and to play a part in the technological advancements downstream, particularly in relation to its metallurgical coal, a key input to the steel production process.

As the [Climate Action 100+](#) engagement co-lead for the company, we also had intensive engagement with the management team on aligning BHP's climate and energy-related lobbying activities to the Paris agreement. During 2020, the company announced a new climate lobbying governance framework, and suspended memberships of some of the industry associations that are not in-line with its new policy. We issued a joint statement with the company ahead of its annual results presentation welcoming its industry-leading approach.

Our engagements with the coal pure-plays, in contrast, revealed that they are mostly in the early stages of dealing with climate change as a material business issue. Engagement with **Shenhua Energy**, China's largest coal mining company, has been a priority for us, and we are currently focusing on how it will respond to China's net zero by 2060 target.

Australia's **Whitehaven Coal** has responded to investor demand by publishing their position on and resilience to the low carbon energy transition<sup>10</sup>. However, its assessment of future demand was largely based on the IEA's 4-degree Stated Policies Scenario<sup>11</sup>, underestimating in our view the risks arising from the decarbonisation in its key Asian markets. Going forward, we plan to intensify our engagements with these two companies, alongside the largely unresponsive Indian miner, **Coal India**.

## Shenhua

### – How will the company respond to China's 2060 Net Zero Pledge?



Shenhua is China's largest coal mining company, with Scope 3 emissions (from the combustion of coal it produces) estimated at well over 600 million metric tonnes<sup>12</sup> – **almost double the entire emissions of the UK economy**. We have engaged the company both one-to-one and as co-lead of the Climate Action 100+ initiative, with 14 points of contact since the start of 2019, including an in-person meeting in Beijing in 2019 and a recent meeting with its ESG Committee.

Whilst the company was initially resistant to discussions on energy transition, the dialogue has become much more productive in 2020. China's announcement of a 2060 net zero goal is a crucial development for this state-owned company. If its response to the government's

goal is insufficient, we believe that there is a real risk of stranded assets. Not only have we seen a larger market share of renewables in Chinese electricity production, but, more notably, Shenhua has been pressed by the government to focus on coal mining in recent years. The subsequent divestment of half of its power generation capacity in 2019 forced Shenhua to rely more on selling coals to external electric utilities (increased to 87% of its coal sold<sup>13</sup>) and less for self-generation in 2020. This repositioning limits the company's ability to benefit from transition opportunities downstream. Unless there are significant advancements in the adoption of CCS technologies, Shenhua may face a shrinking market.

<sup>10</sup> [Whitehaven](#) (2020)

<sup>11</sup> The Stated Policies Scenario is based on the existing policy frameworks and regulatory intentions, including the Nationally Determined Contributions under the Paris Agreement. [IEA](#) (2020), World Energy Model, IEA, Paris

<sup>12</sup> MSCI ESG

<sup>13</sup> [Shenhua](#) (2020) Annual Report

## Engagement at a glance – coal miners

The table below shows an overview of our engagement with coal miners

Coal Miners Engaged	Country	Engagement Type	Responsiveness	TPI Management Score <sup>14</sup>	2050 Climate Goal	Commitment to coal phase out
Anglo American	United Kingdom	CA100+ and 1 on 1	Good	Level 4	Carbon neutrality across operations before 2040	Indicated exit on thermal coal within 5 years <sup>15</sup>
BHP	Australia	CA100+ and 1 on 1	Good	Level 4	Net zero operational emission by 2050	Indicated divestments on thermal coal in 2 years <sup>16</sup>
Glencore plc	Switzerland	CA100+ and 1 on 1	Good	Level 4	A forecast of 30% reduction by 2035	Indicated closures of thermal coal mines by end of life <sup>17</sup>
China Shenhua Energy	China	CA100+ and 1 on 1	Adequate	Level 2	No	No
Whitehaven Coal	Australia	1 on 1	Adequate	Level 2	No	No
Coal India	India	1 on 1	Poor	Level 1	No	No

<sup>14</sup> Rating is given from Level 0 (worst) to Level 4 (best)

<sup>15</sup> [Bloomberg](#) (2020)

<sup>16</sup> [Financial Times](#) (2020)

<sup>17</sup> [Financial Times](#) (2020)



## 2020 engagement with electric utility companies

With the economics of renewable energy becoming ever more favourable, the opportunities for electric utility companies to diversify their businesses away from coal are more obvious than for coal miners. However, the sector still faces some complex challenges, particularly given the heavily regulated nature of electricity markets and the need to balance emissions control with reliability and affordability.

**1** **Government policy and regulation**

An important feature of the electric utilities sector is the heavily regulated nature of the electricity market. Governments and regulators, at national and/or local levels, set guidance which seeks to balance environmental considerations around climate change and local air pollution; social issues around access and affordability; and energy security. In some markets, electric utilities remain state-owned or controlled. In the US, there is a complex picture of state-level regulation, meaning that some electric utility companies operate in a competitive market, whereas others have their allowed rates of return set by state regulators. All, by their nature, have intensive relationships with their regulators.

In our engagement, we asked about how companies interacted with governments and regulators, and we saw a range of responses.

- Some act as ‘**takers**’ of policy – looking at the current regulatory environment and setting policies accordingly, and resisting change.
- Others are ‘**makers**’ – setting policies which are more ambitious than regulations require, and seeking to influence the policy discourse in line with these ambitions.

- In our engagement, **TEPCO** and **Chubu** in Japan, and **KEPCO** in South Korea, all emphasised the consistency of their approach with national policy goals. In both cases, these national targets were subsequently tightened – leaving the companies needing to catch up.

### A more proactive approach: National Grid

National Grid has published detailed analysis of how the UK’s electricity infrastructure needs to evolve in order to achieve the country’s net zero target. 2020 has seen disagreement between National Grid and the regulator, Ofgem, about the amount of investment it is permitted to make, which the grid operator claims is insufficient to achieve the energy transition.

We joined with other investors to write to Ofgem to emphasise the importance of ensuring that allowed rates of return account for the costs of achieving a net zero future. This is not an issue unique to the UK – the International Energy Agency estimates that **investment in electricity networks will need to reach over \$800bn by 2030, up from \$270bn in 2019**<sup>18</sup>.

<sup>18</sup> [International Energy Agency World Energy Outlook 2020](#)



## Japan’s difficult path to decarbonising electricity

We identified Japanese electric utilities TEPCO and Chubu as engagement priorities in 2019, when they formed a joint venture – JERA – to take control of their domestic power assets, including both existing coal-fired generation and planned new coal-fired power. We were concerned that the reliance on coal was inconsistent with alignment to the Paris agreement.

In our 2019 engagement, both companies stressed the alignment of their strategies with the Japanese government target, which at that time was an 80% cut in emissions by 2050. They also shared concerns about the limitations to Japan’s path to decarbonising energy, including the temporary or permanent closure of much of the country’s nuclear capacity after the Fukushima disaster. Whilst appreciating the difficulties, we pushed back on this and stressed that future plans needed to be stress-tested against a range of different climate scenarios, not just current policies.

We followed up with TEPCO with a further meeting and feedback on their strategy in 2020; the company emphasised that the decarbonisation of JERA’s assets was now a matter for the Board of the JV. The apparent distancing from JERA’s decision-making was a concern, and potentially limits accountability to shareholders. However, we saw progress in October this year as JERA announced a net zero 2050 target – shortly before the Japanese government made the same commitment – and the closure of less efficient (supercritical or less) coal power by 2030.



### Technology

A second common obstacle cited by utility companies has been the availability of alternative technologies to fossil fuels. The cost of wind and solar power has plummeted in recent years – increasingly, they are cost competitive on a stand-alone basis with fossil fuels. However, local conditions vary widely in their suitability due to factors such as land availability and the local climate, and intermittency and grid stability remain key concerns.

Our engagement with US utility companies has highlighted how they are grappling with this. **Vistra Corp**, one of the country’s largest greenhouse gas emitters in the sector, was at first resistant to adopting a net zero target, citing concerns about whether it was technologically possible.



...it may be useful for Ofgem to carefully review the adequacy of net zero transition plans from UK utility companies as part of these discussions ... This approach should assist the process of negotiating a fair rate of return that reflects the cost of investment required to deliver the investments needed for the UK’s Net Zero targets

**Investor statement on RIIO-2 draft determinations, November 2020**



When we asked the company's CEO what he saw as the key obstacle to decarbonising electricity, he cited the urgent need for affordable battery storage with a life of several hours to smooth out the peaks and troughs of renewable power production. The company has, however, subsequently adopted a net zero target, bringing it in line with US peers, with an implementation strategy including investment in renewable energy and battery storage. **Duke Energy** was the first large US utility to publish a climate scenario analysis; its latest report still has unspecified zero-emissions technologies accounting for a significant share of future generation in its 2050 illustrative scenarios, as it does not yet know what technologies may be available to make up the balance with renewable energy.

Proactive companies are shaping future technology developments, rather than waiting for them to emerge. One US example is **AES Corp** – the first US utility to support the TCFD – who we engaged in 2018. They have a joint venture with **Siemens**, which is focused on developing energy storage systems.

Progress in the Chinese market is much more limited. Despite the country being the world's largest investor in renewable energy technologies, most electric utilities have been resistant to setting long-term targets or coal phase-out plans. We believe that the lack of policy certainty in the past was the major reason of the absence of long-term commitments, as many of these utilities are state-owned enterprises – the new national target is likely to enable progress. In contrast Hong Kong-based **CLP Holdings** has pledged to stop all new coal investment and phase out existing coal-fired power by 2050.

“ ”

Proactive companies are shaping future technology developments, rather than waiting for them to emerge.

#### Social impacts

As with coal miners, we have been asking electric utility companies how they will manage the impacts of coal phase-out on their workforce and local communities. Some, such as Drax, have taken the approach of keeping their existing plants open, but converting them to use less-polluting fuels. Drax is using biomass, from paper production waste and other sources. JERA, the TEPCO and Chubu joint venture, recently announced its intention to use ammonia, initially alongside coal, as a combustion fuel for its thermal power plants by 2030. As we reported in our [Viewpoint](#) earlier in the year, such approaches can work but need extreme care as they can have unintended consequences.

Other companies are closing their plants altogether. In these cases, we have called for support for workers to retrain and find new employment, and for communities to smooth the transition.

## Engagement at a glance – electric utility companies

The table below outlines our engagement with electric utilities companies

Electric Utilities Engaged	Country	Engagement Type	Responsiveness	TPI Management Score <sup>19</sup>	2050 Emissions Goal	Commitment to coal phase out
Duke Energy	US	CA100+	Good	Level 3	Net zero	No
Vistra Corporation	US	CA100+	Good	Level 2	Net zero	No
Dominion Energy	US	CA100+	Good	Level 4	Net zero	No
Korea Electric Power Corp	S Korea	CA100+	Adequate	Level 3	No	No
Tokyo Electric Power	Japan	1 on 1	Adequate	Level 4	JV only <sup>20</sup>	No
Chubu Electric Power	Japan	1 on 1	Adequate	Level 3	JV only	No
CLP HOLDINGS LIMITED	Hong Kong Special Administrative Region	1 on 1	Good	Level 4	80% cut from 2007 levels	Yes, by 2050
Huadian Power International Corporation Limited	China	1 on 1	Adequate	Not assessed	No	No
China Power International Development Limited	China	1 on 1	Poor	Not assessed	No	No
China Resources Power Holdings Company Limited	China	1 on 1	Poor	Level 1	No	No
Datang International Power Generation	China	1 on 1	Poor	Not assessed	No	No
Huaneng Power International	China	1 on 1	Poor	Not assessed	No	No

<sup>19</sup> Rating is given from Level 0 (worst) to Level 4 (best)

<sup>20</sup> JERA, the power generation JV of TEPCO and Chubu, has adopted a 2050 net zero emissions target



“At BMO, we view engagement not only as a tool to identify and manage risks, but also as a route to create positive impact for the environment and society.”

**Kristi Mitchem, CEO,  
BMO Global Asset Management**

## Next steps



2021 will be a critical year for climate change, and we intend to intensify our engagement efforts in relation to coal phase-out. We will be looking to follow up with companies that have announced 2050 targets to press them on implementation, including setting a firm coal phase-out date. We will continue to prioritise China and the US, as the recent and upcoming policy changes create an urgent need for laggard companies to respond; we will also look to engage laggard companies in more challenging markets, including India.

## Responsible Investment – a glossary of terms

Its wide-ranging nature means that responsible investment involves a host of associated language and jargon. Here we explain some of the most commonly used terms.



### Active ownership

Discharging responsibilities as investors and owners in a company through engagement and voting to influence the management of environmental, social and governance (ESG) issues.



### Stewardship

The responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.\*



### Environmental, Social and Governance (ESG)

A framework that breaks the broad concept of sustainability down into these 3 key issues.



### Engagement

Entering dialogue with companies after investment, to support and encourage positive change in the management of key ESG issues.



### Proxy voting

Exercising the right to vote on resolutions at company shareholder meetings. It compliments engagement as a key tool for influencing change.



### Sustainable Development Goals (SDGs)

The 17 goals set by the United Nations in 2015 are a global framework for achieving a better and more sustainable future. They address the global challenges we face, including those related to poverty, inequality, climate, environmental degradation, prosperity and peace and justice. The UN is targeting completion of all 17 interconnecting goals by 2030.

## Contact us



[bmogam.com](https://www.bmogam.com)



Follow us on LinkedIn

\* [https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship\\_Code\\_Final2.pdf](https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship_Code_Final2.pdf), p. 4. The Investment Association reserves the right to review its alignment with the FRC definition at any time.

Views and opinions have been arrived at by BMO Global Asset Management and should not be considered to be a recommendation or solicitation to buy or sell any companies that may be mentioned.

The information, opinions, estimates or forecasts contained in this document were obtained from sources reasonably believed to be reliable and are subject to change at any time.