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CLOSING COAL LOOPHOLES

SECURING A CLEAN ENERGY SECTOR STRATEGY FOR THE ASIAN INFRASTRUCTURE INVESTMENT BANK

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Summary

> The new Asian Infrastructure Investment Bank (AIIB) has a great opportunity to catalyse investment in clean energy infrastructure across Asia. Doing so would advance China's international influence and growing leadership on climate change.

> Asia is home to 92% of the world's proposed coal-fired power plants. World Bank President Jim Yong Kim has warned of the dangerous climate impacts that would follow if these plants were to be built.

> The AIIB board will shortly agree on its first Energy Sector Strategy (ESS). This will set the direction of travel for the Bank's lending decisions. The aims of the draft strategy are broadly positive but the details are poor, allowing for loopholes in respect to the financing of coal.

> Contrary to the aims of the ESS, the proposed approach to coal power plant projects has been pushed by coal exporters seeking to lock in demand and thus includes several loopholes for coal finance.

> Any AIIB funding for new coal-fired power generation would be a bad use of public money and bad for the AIIB's aim to be a 'lean, clean and green' bank. Coal projects are poor investment options compared to increasingly competitive renewables, especially when the full costs of pollution control and lifetime CO2 emissions are considered.

> There is still an opportunity for the AIIB board to provide clearer and more robust restrictions on coal power generation projects, thus closing existing loopholes. Countries in favour of climate action must step up their support for clear rules on coal. The AIIB should seek to match or surpass current best practice approaches implemented by the European Investment Bank and OECD.

> The five G7 countries of Canada, France, Germany, Italy and the UK are all members of the AIIB. They must take the lead in advocating in favour of tighter

constraints on coal. Doing so will help position the AIIB as an International Financial Institution that can deliver a transformative infrastructure agenda.

Introduction

The new Asian Infrastructure Investment Bank (AIIB) was created by China in 2015 as a new multilateral institution designed to drive investment into infrastructure projects across Asia. The mandate of the AIIB, as expressed by the bank's President Jin Liqun, is to be 'lean, clean and green'. Over the past 18 months the AIIB has been developing its internal priorities and processes to deliver on this.

In June 2017, the AIIB will hold its annual general meeting, where it aims to approve its first Energy Sector Strategy (ESS). The AIIB has positive aims for the ESS, which the draft text states as:

> "The Strategy embraces, and is informed by, the principles underpinning the Sustainable Energy for All (SE4ALL), the 2030 Agenda for Sustainable Development, and the Paris Agreement (Box 1). It lays the framework for the Bank to support its client countries to: (i) develop and improve their energy infrastructure and facilitate their transition to a less carbon-intensive energy mix; and (ii) meet their goals and commitments under these global initiatives."[1]

Unfortunately, the same draft version of the ESS fails to adequately restrict finance to coal-fired power plants, instead including deliberate loopholes for example allowing claims of grid 'reliability and integrity' to justify new coal or allowing coal where no alternative is deemed available without saying how this assessment would be made. E3G understands that these have been proposed by member countries such as Australia and Indonesia that are seeking to promote demand for coal exports through encouraging a new wave of coal-fired power plants.

Context: The AIIB's Energy Sector Strategy

As a new multilateral bank, the AIIB seeks to differentiate itself from its competitors. By leapfrogging over dirty technologies and catalysing investment in clean infrastructure the AIIB can show its commitment to clean energy and the Paris Agreement. The AIIB must make its position on limiting investment in coal clear and unequivocal from the outset however.

To this end, the ESS must focus on the long-term 2050 decarbonisation pathway required by the Paris Agreement. Ruling out the financing of new coal power plants must be a part of this, as any newly constructed plants would aim to continue operating beyond 2050. The AIIB can take a strong position by arguing new coal power plants are poor investments – they have bad project economics, are bad for the climate and human health, and are bad for the AIIB's reputation. Their lifetime CO2 emissions are incompatible with the required decarbonisation of the power sector. The business case for expensive and polluting coal plants is now increasingly undermined by cleaner, cheaper alternatives.

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Unfortunately, however, the AIIB's current proposals fail to match standards set by other multilateral banks (such as the European Investment Bank) or international rules on private sector investment (such as the OECD sector understanding on export credits for coal-fired electricity generation projects). The current draft ESS text on coal is not fit for purpose. Further, in an alarming development, concern has been raised that a further internal Bank draft contains proposals for even weaker language than the already unfit consultation text that is analyzed below.

The AIIB urgently needs to table a new proposition to resolve this conflict. In line with precedents set in other International Financial Institutions, the simplest solution would be the introduction of an Emission Performance Standard for fossil fuel projects that rules out coal-fired power plants unless they are required to operate with carbon capture and storage technology.

This briefing paper analyses weaknesses within the current consultation text and sets out recommendations for what should be done to ensure that the AIIB is indeed 'lean, clean and green'.

Analysis: Weakness of the draft Energy Sector Strategy

This section provides analysis of paragraph 36 of the ESS text, previously released for public consultation:

"The Bank would finance investments that are demonstrably compatible with a country's transition toward sustainable, low-carbon energy and internationally agreed targets."

> This introductory text is a positive start, but it should be strengthened further to say that the bank would only finance investments that are demonstrably compatible with a country's transition toward sustainable, low-carbon energy and internationally agreed targets.

> For any proposed coal-fired power plant to be 'demonstrably compatible' it must be assessed based on its lifetime emissions and intended operational regime (e.g. baseload / peaking etc.). Any new coal-fired power plants with a proposed lifetime beyond 2030 must also be accompanied by detailed proposals for the initial application or rapid retrofit[2] of CO2 capture plus detailed plans for CO2 transportation and geological storage (at the project level) and there must be a national CO2 storage strategy in place. In the absence of these, coal-fired power projects should be assumed to not be demonstrably compatible with these goals. In such a case, these projects should be restricted to a project lifetime of 15 years or less.

"Supported fossil fuel based generation facilities would be expected to use commercially available least-carbon technology."

> The reference to 'commercially available' technology is deceptive. Since the question of 'commercial availability' has long been a topic disputed by the coal industry and utility companies,[3] one could speculate this has been drafted to deliberately exclude the mandatory use of carbon capture and storage (CCS) technology. In the case of CCS, commercial deployment is not only a question of technology, but also requires access to CO2 infrastructures and geological storage. Furthermore, CCS requires financial incentives and regulations (such as carbon pricing or emissions performance standards) to restrict investment in 'unabated' fossil fuel use and drive the creation of a market for CCS. The coal industry continues to hide behind the future prospect of CCS while opposing government efforts to introduce these kinds of measures.

"In many countries, gas-fired power generation would form part of such transition…"

> Gas-fired power generation is more likely to be able to support the deployment of renewables through being used as a flexible generation option. Gas has lower capital costs and shorter operating lifetimes which reduces the risk of stranding of these assets. Although gas-fired generation has lower CO2 emissions than coal, the AIIB should assess the lifetime emissions from proposed investments in gas, particularly those associated with the creation of pipeline infrastructure that could lock in CO2 emissions beyond 2030.

"…Carbon efficient oil and coal-fired power plants would be considered…"

> The simplest way of strengthening this clause would be to state that fossil fuel power plants would only be considered where they met an Emissions Performance Standard (EPS) with CO2 emissions less than 550gCO2/kWh. These standards are already applied for projects considered by the European Investment Bank. Similar policies are also in place domestically in the UK and Canada.[5]

If the AIIB fails to introduce a clear measure ruling out all unabated coal then it will need to significantly tighten loopholes. This includes requiring projects to meet all three tests not just one. Such an approach should also be required for any exemptions granted to an EPS if it were to be included.

"…if they replace existing less efficient capacity…"

> This text deflects the need to consider lifetime emissions from fossil plants compared to renewable alternatives, not simply their relative efficiency compared to existing fossil fuel generation. The clause should be strengthened to say new coal-fired power generation would 'only' be considered if it is to replace a less efficient plant with the same capacity at the same location. The clause should also require this restriction be integrated into relevant permitting and planning processes. Doing so would rule out new greenfield plant elsewhere increasing the capacity of coal generation overall without requiring the retirement of older power plants.

"…or are essential to the reliability and integrity of the system,…"

> This text bolsters the claims of incumbent generators rather than enabling new technologies such as demand side technologies and flexible generation. This clause must be defined with respect to alternative grid investments including interconnection, demand side measures - including demand side response and storage- and alternative generation options. Considering increasing variable generation, priority should be given to flexible peaking plant rather than baseload coal generation. The Bank should commit to developing further criteria for making this assessment. The 'or' should be removed and replaced by 'and'.

"…or if no viable or affordable alternative exists in specific cases,…"

> This text is meaningless unless the process of determining both project viability and the thresholds for different country circumstances are defined. The clause needs to be accompanied by a commitment by the AIIB to develop a robust assessment criteria taking account of life cycle emissions of the proposed plant, using renewable energy alternatives as the baseline. Again, the 'or' should be replaced by 'and'.

"…particularly in low income countries."

> This clause needs strengthening, replacing 'particularly' with 'only', thereby restricting coal lending to only provide finance to low income countries and only in special circumstances. Projects in these countries must have a significant/material impact on poverty alleviation and economic development. Any such exemption should seek to go beyond the criteria laid down in the OECD Export Credit Agency framework[6] by setting out clear criteria of the following: which categories of country would qualify, what assessments of alternatives would be required ahead of approving investment in coal, and what kinds of coal technology would be permitted in each case. The OECD guidelines are in place to limit public sector guarantees for private sector investments. The AIIB approach should be stronger as it must safeguard the use of public money invested into infrastructure projects.

Conclusion: Closing the Coal Loopholes

As detailed above, the proposed Energy Sector Strategy contains substantial loopholes which might allow new coal projects in by the back door. Especially since these loopholes have been combined in a manner that a new fossil plant only need pass one of these loopholes to qualify for support.

E3G's understanding is that these loopholes have been intentionally inserted by member countries pushing a destructive pro-coal agenda. Such an approach would undermine the AIIB's aim to catalyse investment in clean infrastructure across Asia from the very start.

China and its international partners will need to prioritise efforts to push back against this regressive approach. G7 countries Canada,[7] France, Germany, Italy and the UK are all members of the AIIB, and must step up to help close these coal loopholes in the final version of the Energy Sector Strategy.

The AIIB needs to replace the current failing language by screening any fossil fuel investment using an EPS of 550g/kWh and limiting any exemptions to low income countries (defining this to be no worse than OECD Export Credit Agency criteria).[8]

In the absence of an EPS, or if exemptions are included, then any coal-fired power plant project put forward for AIIB funding should be required to demonstrate compatibility with host country climate commitments. Detailed criteria should also be put in place to ensure any such projects:

> Only replace existing capacity of the same size and location;

> Undertake a full assessment of lifetime emissions and alternative generation and system options; and

> Produce plans and timelines for the application and/or retrofit of carbon dioxide capture, transportation and storage.

About E3G

E3G is an independent climate change think tank operating to accelerate the global transition to a low carbon economy. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere. In 2016, E3G was ranked the number one environmental think tank in the UK.

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ENDNOTES

[1] Para. 4 of the Energy Sector Strategy. **https://www.aiib.org/en/policies-strategies/strategies/.content/index/Energy-Strategy-Discussion-Draft.pdf**

[2] In January 2017, the Petra Nova project (a joint venture of NRG Energy and JX Nippon Oil & Gas Exploration) officially entered operation, showing that CCS retrofit can be deployed on a technical basis.

[3]For example the US EPA previously found that CCS was sufficiently commercially available to enable CCS to be included as a means of abatement for meeting new source emission standards in the US. Conversely, coal companies and utilities claimed that CCS wasn't commercially viable, as they don't want to be forced to use it.

[5] Alternatively, if the AIIB were to want to be more creative as a pathfinder for clean energy investments it could set an explicit lifetime CO2 budget for each power plant. However, this would require additional effort to define an appropriate approach and is unlikely to be possible within the limited time before a decision is made.

[6] The OECD ECA guidelines specify plant size and efficiency levels for coal plant investment with reference to countries that are eligible for International Development Assistance
http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/PG(2015)9/FINAL&docLanguage=En

[7] **http://www.reuters.com/article/us-china-aiib-idUSKBN16U0CG**

[8] The OECD ECA agreement makes specific provision for the size and efficiency of coal fired plants limiting support to countries eligible to receive International Development Assistance support.
http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/PG(2015)9/FINAL&docLanguage=En