Tim Buckley, Director Energy Finance Studies
July 2019

BHP to Link Executive Compensation to Reductions in Emissions Generated from the Use of Its Products

Evaluating and Reporting Scope 1-3 Emissions Is a Landmark Commitment, Showing Leadership Towards Implementation of the Paris Agreement

BHP Group announced plans today to link company executive compensation to reductions in the total emissions of its product portfolio, with the landmark decision to include Scope-3 emissions – the carbon emissions generated by customers' use of BHP products like coal, oil and gas.

CEO Andrew Mackenzie today also called on governments to introduce regulatory and policy responses to prevent emitters from outsourcing their carbon footprint to others – a position at odds with current Australian government policy.

In addition to gas (LNG), oil and its coking coal mines that supply the steel sector, BHP's remaining exposure includes thermal coal mining (used for power generation) from its 18 million tonne per annum (Mtpa) Mt Arthur mine in New South Wales, Australia and its 33% stake in the 30Mtpa Cerrejón, Columbia mine.

BHP's move to evaluate and disclose the entire value chain of products the company is involved in will provide significantly enhanced transparency and is a key step towards helping to implement a global climate solution aligned with the Paris Agreement.

While BHP's Chief Financial Officer Peter Beaven announced in May 2019 that BHP had "no appetite for growth in energy coal regardless of asset attractiveness",[1] little comment was made of this today.

Instead, Mackenzie provided increased clarity on his company's relationship to the thermal coal sector[2] in a piece penned in the Financial Times,[3] committing BHP to a $400m 5-year climate-related investment program to research and implement global warming actions in addition to the Scope 3 emissions reductions.

IEEFA considers this entirely logical. When reviewing an asset's retention strategy, it is best not to box the company into a particular path or timetable ahead of time, particularly given the diminishing market appetite for an increasingly technologically challenged asset such as thermal coal. Retention is a potentially sound strategy in the absence of strong buyer interest. This allows for an orderly

[1] Australian Financial Review, BHP dark on thermal coal's future, 22 May 2019
[2] Bloomberg. Australian Thermal Coal Leaves Investors Cold. 11 July 2019.
[3] Financial Times, Miners have a role to play in fighting climate change, 23 July 2019.

optimisation, closure and clean-up path from a well-capitalised and credible firm, potentially also best protecting stakeholders - including the workforce.

BHP is again proving to be a positive player showing agility in decision making when the going gets tough: they did it twenty years ago exiting steel in Australia, they did it more recently exiting shale in the U.S. (albeit not before destroying $20bn of shareholder wealth[4]), and now the company appears to be limiting its losses in the thermal coal sector.[5]

While BHP lags that of Rio Tinto's progressive thermal coal exit over 2014-2018, its latest moves highlight the tough decision making required of big players and the declining legitimacy of thermal coal.

Global capital flight pressures are building, with new coal exit announcements occurring weekly in 2019. Leading Japanese trading houses have also exited thermal coal over the last year.

BHP started its coal exit with the spin-off of South32 from BHP Billiton in 2015 following shareholder approval for a different investor trajectory. In its 2017 Climate Statement,[6] South32 made it clear it saw the thermal coal sector as structurally challenged, and throughout its short life has been working to exit its 25Mtpa South African coal division, with progress slow. Press reports suggest further write-downs are expected, despite a book value of just $70m.[7]

Global group Rio Tinto began its exit even earlier. The company learnt that coal investments can be value-destructive with its 2010 takeover of Riversdale Mining in Mozambique, a 45Mtpa debacle that saw US$3.7bn of shareholder wealth destruction.[8]

As a result, Rio Tinto's board was instrumental in commencing an orderly coal exit from 2014,[9] allowing a process that maximised shareholder value retention before stranded asset risks were generally accepted. This process was completed in 2018 with the sale of Rio Tinto's Hunter Valley coal assets to Yancoal and Glencore, and then with the sale of its Queensland coking coal mines to EMR Capital and Adaro Energy.[10]

One of Australia's largest industrial companies, Wesfarmers exited its last coal asset in August 2018 with the sale of its 40% stake in the Bengalla thermal coal mine to New Hope Corporation.[11] This followed its sale of the Curragh coking coal mine for

---

[4] The West. BHP's mea culpa for $20b US shale losses. 22 November 2018.
[5] Australian Financial Review, BHP moves closer to thermal coal exit, 12 July 2019.
[6] South32. FY2017 Our approach to climate change.
[7] Financial Times. Coal write down looms at South32. 19 July 2019.
[8] The Australian Financial Review. How Rio Tinto's Mozambique mess unfolded. 18 October 2017.
[9] Renew Economy. Rio Tinto's restructuring signals global industry move away from coal. 5 March 2015.
[10] ABC News. Rio Tinto completes its exit from coal with sale of Queensland mine. 26 March 2018.
[11] Wesfarmers. Agreement to sell 40% interest in Bengalla joint venture. 7 August 2018.

$700m to Coronado Coal in December 2017 and the $297m sale of its Premier thermal coal mine in Western Australia to Yancoal of China back in 2011.

Wesfarmers pivoted from the structurally challenged, emissions intensive, subsidy requiring coal sector into rare earths (Lynas Corp) and lithium mining (Kidman Resources),[12] both of which are set to see demand boom as electric vehicles and battery storage technologies continue to develop in support of zero emissions industries of the future.

This week in the U.S., another coal miner has gone into Chapter 11 bankruptcy: Blackhawk Mining LLC owes over US$1bn putting 2,800 workers at risk.[13] This follows the bankruptcy of the sixth largest U.S. coal producer BlackJewel LLC earlier in July 2019, disrupting 1,700 workers and their communities while leaving 20 years of mining at rehabilitation risk.[14] In June 2019, Cambrian Coal also entered Chapter 11.[15]

And in Japan, most trading houses are in the process of exiting thermal coal mine ownership. Marubeni Corp led the divestment process with its landmark new coal exit policy of September 2018.[16] Since then, divestments have been made by Mitsubishi Corp., Mitsui & Co., Itochu Corp and Sojitz.[17]

In July 2019, Chubb become the first U.S. insurer to announce a coal restriction policy,[18] recognising the reality of climate change and the need for a transition to renewable fuel solutions. Chubb will not underwrite risks related to the construction and operation of new coal-fired plants, nor for companies deriving more than 30% of their revenues from thermal coal mining.

As a result, 114 significant financial institutions globally to-date have announced new policies on thermal coal lending, divestment and/or insurance restrictions or exclusions.

Restriction on coal financing is accelerating, moving from one major financial institution announcement every two weeks in 2018 to one per week to-date in 2019. There have been 22 coal divestment announcements from globally significant financial institutions in 2019, being either new company restrictions (e.g. MM Group of Netherlands in May 2019[19]) or a tightening of existing coal exclusion policies (e.g. KfW of Germany in July 2019[20]).

---

[12] The Sydney Morning Herald. Kidman bid not a replacement for Lynas, says Wesfarmers chief. 2 May 2019.
[13] Bloomberg. Blackhawk Files Chapter 11, Joins List of Bankrupt Coal Miners. 20 July 2019.
[14] Vox. Coal left Appalachia devastated. Now it's doing the same to Wyoming. 9 July 2019.
[15] Globalnewswire. Cambrian Coal Elected to File Voluntary Petitions for Relief Under Chapter 11 on June 16, 2019 and Obtains Financing for Its Restructuring. 16 June 2019.
[16] Marubeni Corp., In relation to Coal-Fired Power Generation Business, 18 September 2018.
[17] IEEFA, Japanese Thermal Coal Consumption Approaching Long Term Decline, July 2019.
[18] Chubb. Chubb Coal Policy. 1 July 2019.
[19] MM Group. Statement on Coal. May 2019.
[20] Clean Energy Wire. Germany's KfW Bank rules out financing of any coal operations. 3 July 2019.

IEEFA started formally tracking this accelerating trend away from coal with our February 2019 report Over 100 Global Financial Institutions Are Exiting Coal, With More to Come. This report reviewed public and private banks, credit agencies and insurance groups which have restricted coal financing, with the list now including 45% of the top 40 global banks and 24 globally significant insurers. The majority of the institution's announcements are 'climate' policies reflecting an acceptance of climate science and a serious reorientation of business strategies.

In March 2019 the Reserve Bank of Australia's Deputy Governor Guy Debelle stated that climate change will be an 'abrupt and disorderly' blow to Australia's financial stability. Debelle called for an orderly transition to a low carbon economy.[21]

In limiting climate change to 1.5-2°C of warming as per the global Paris Agreement, IEEFA notes fossil fuel extraction must rapidly decrease towards zero net emissions. All countries must instead accelerate reliance on sustainable, affordable and renewable sources of energy, and accelerate energy efficiency and electrification of the transport sector as the top priorities to avoid catastrophic global warming.

BHP is showing itself as a company likely to survive the energy transition, while laggards like Glencore, Whitehaven and Adani that continue to invest in a dying industry are creating huge cost burdens for banks, insurers, governments and local communities.

We note and support the Australian Centre for Corporate Responsibility's continued call for BHP to ensure its industry lobbyists either align with BHP's position or cease association with climate denying laggards. Clearly BHP's warnings of 2018 are not being heeded and it is time to hold industry bodies to the same standard as BHP aspires to.

Today's announcement shows BHP is aiming to be progressive and better able to respond to rising shareholder and community concerns by taking responsibility for significantly reducing polluting emissions and addressing global warming and future energy needs.

Overall, BHP's statement today is an important milestone that builds momentum towards global action to better align with the Paris Agreement.

Without that alignment, the future is uncertain and increasingly dire.

[21] Reserve Bank of Australia. Climate Change and the Economy. 12 March 2019.

About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Author

Tim Buckley

Tim Buckley, IEEFA's director of energy finance research, Australasia, has over 30 years of financial market experience covering the Australian, Asian and global equity markets from both a buy and sell side perspective. Tim was a top-rated Equity Research Analyst and has covered most sectors of the Australian economy. Tim was a Managing Director, Head of Equity Research at Citigroup for many years, as well as co-Managing Director of Arkx Investment Management P/L, a global listed clean energy investment company that was jointly owned by management and Westpac Banking Group.