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Service: Corporate & Commercial
Sector: Energy & Resources

Climate Change – the gathering legal and policy storm in Australia and its impact on the energy and resources sector

Recent developments suggest that the law in Australia is shifting inevitably towards a more climate change conscious approach for business.

Developments include changes in the way energy and resources projects may be assessed and approved based on their carbon emissions; and the disclosures companies may have to make in relation to climate change risks.

We investigate these changes in law and policy and suggest some solutions on how companies may mitigate their risks.

A clear shift towards a more climate conscious business environment in Australia is suggested by a number of recent developments in the law that have a significant impact on the energy and resources sector. These developments include:

- the proposal for guidelines by the Western Australian Environmental Protection Authority requiring that proponents with scope 1 emissions in excess of 100,000 tonnes of carbon per annum have a net zero carbon policy (now withdrawn pending consultation);
- the recent case of *Gloucester Resources Limited v Minister for Planning* [2019] NSWLEC 7, where the court rejected the appeal by Gloucester Resources against a decision to refuse the Rocky Hill Coal Project by the NSW Planning Assessment Commission, citing various adverse social, environmental and climate change impacts;
- recommendation 7.4 in the newly released *Corporate Governance Principles and Recommendations Fourth Edition (4th Edition)*, dealing with the importance of a listed entity's consideration of social and environmental risks, including climate change; and
- the rise of shareholder activism focussed on climate change risks.

If they are not already doing so, energy and resources companies need to urgently consider how they can mitigate the risks created by this change in approach.

WA EPA Proposed Guidelines

On 7 March 2019 the Western Australian Environmental Protection Authority (**WA EPA**) introduced updated emissions guidelines, requiring proponents with scope 1 emissions in excess of 100,000 tonnes of carbon per annum to offset any residual (net) direct emissions associated with the proposal. The impact of the proposed guideline would have been significant on companies with operations in Western Australia, likely causing practical difficulty for implementation and delays, degrading investor confidence and added costs.

On 14 March 2019, following outcry from the energy and resources sector, the EPA withdrew the proposed guideline and committed to a public consultation process on the future emissions guidelines.

A major criticism, echoed by much of the industry, was that the proposed WA EPA guidelines were unachievable, with uncertainty regarding implementation of the full carbon emissions offset. The proposed guideline could have the effect of delaying major Liquefied Natural Gas (**LNG**) projects by shifting the focus to implementing carbon offsetting environmental projects. This has been reported as potentially delivering an impact of $14.2 billion to the LNG and wider gas industry, as well as having the potential to prevent operations in WA from efficiently accessing and delivering on agreements in the national and global markets. This presents difficulties to companies trying to secure lenders or investors to finance their operations, as operating delays can impact investor timelines and delay financial returns. Introducing stringent guidelines will affect the operations of these companies and subsequently detriment investor confidence in the industry.

A further criticism of the proposed guideline was the costs that companies will incur. The Australian Institute, a public policy think tank, looked into the costs from offsetting carbon emissions from Chevron's Gorgon and Wheatstone operations. It suggested that the cost to fully offset carbon emissions at these operations will be 2.16% of the combined cash surplus, or 1.74% if Chevron could implement its underground carbon storage facility. Costs may further be incurred indirectly from delays, decreased share value and operating inefficiencies as a result of compliance and concerns with the proposed guideline.

It also leaves WA unfavourably exposed to a competitive disadvantage to the other states, as the proposed guideline would apply to operations in WA rather than on a federal level. This means that companies operating in WA will have to satisfy the full carbon neutral offsetting guideline, whilst competitors in other states are not burdened with a similar requirement. The proposed guideline is further likely to catch out existing operations in WA seeking approval for changes and variations if it were to be implemented immediately.

The result would be reduced local investment activity in Western Australia and a deterrence of prospective investors, inducing energy and resources companies to focus on projects interstate or overseas, in a more favourable regulatory environment. These practical issues culminate into general uncertainty in regard to the operation, implementation and consequences of the proposed WA EPA guideline; affecting company activity within the state, investor confidence and operational productivity.

Until the consultation period ends, we will not know how the proposed guidelines may be changed or the full impact of them on the energy and resources industry.

It appears that the objective of this further consultation with industry and stakeholders will be to ensure the proposed guidelines can be practically implemented and that they are fully complementary to Commonwealth regulation.

If companies want to have an input on these guidelines they should engage with the WA EPA in the consultation process.

Rocky Hill decision

The recent and much publicised decision in the NSW Land and Environment Court in *Gloucester Resources Limited v Minister for Planning* [2019] NSWLEC 7 (**Rocky Hill decision**) has caused a level of discomfort for companies engaging in mining projects in New South Wales, as well as the energy and resources sector generally.

The case concerned the appeal by Gloucester Resources Limited (**GRL**) against a decision to refuse the Rocky Hill Coal Project by the NSW Planning Assessment Commission. In rejecting the appeal, the Court:

- cited significant adverse impacts on the visual amenity and rural character of the town of Gloucester with significant impacts on existing uses of land in the mine's vicinity;
- found that the contribution of the project's greenhouse gas emissions to climate change were unhelpful to achieving targets;
- found that the costs of the mine would exceed the economic benefits;
- held that scope 3 future emissions from offshore combustion of exported coal can constitute a valid ground for refusal due to the causal link to climate change;
- rejected the market substitution argument (i.e. that investment rejected at Rocky Hill would instead flow to other large coal producers and coal mines overseas, rather than into the Australian economy); and
- stated that Australia has an initiative to lead the way to achieve emissions targets.

The Rocky Hill decision has wider reaching repercussions than for just GRL's operations. It has implications for the viability of future coal and fossil fuel developments and could impact on participation decisions by banks, lenders and investors who would traditionally engage with this industry. It also imposes stricter scrutiny when assessing the environmental and social impact of a project, which becomes particularly important to consider when an approval decision is challenged by environmental and community groups.

The Court interpreted scope 3 emissions to fall within the term downstream emissions, meaning that emissions from burning the mined coal need to be considered when assessing the environmental impact of the project. As such, companies proposing a mine should thoroughly address the direct and indirect greenhouse gases from the project, as well as explicitly account for scope 3 emissions.

The Court's decision to evaluate the merits of each particular development involved a consideration of the proposal's greenhouse gas emissions and its likely contribution to climate change, as well as a consideration of adverse costs through environmental, social and economic impacts. As a result, the approval process may show a preference to smaller projects with lower emissions, projects that are favourably located and projects with lower adverse costs. This means that as part of its approval process, an entity may need to address the project's methodology for its carbon budget and include a comparison of the project's emissions relative to those of similar projects to show how the project can minimise emissions and provide environmental benefits.

Another implication from this case is that an entity should have clear procedures for its carbon mitigation. GRL's argument that the climate change impacts of the Rocky Hill project could be mitigated by removing enough carbon from the atmosphere to counteract the project's emissions was found to be too hypothetical as no evidence was provided to show how this would actually be done. This suggests that if greenhouse gas emissions are to be key in determining approvals, companies should have a clearly defined process detailing how the carbon offsets for direct and indirect emissions will be achieved for the particular proposed project.

In contrast, on 22 March 2019, the NSW Land and Environment Court in *Australian Coal Alliance Incorporated v Wyong Coal Pty Ltd* [2019] NSWLEC 31 rejected a challenge put forth by the Australian Coal Alliance against Wyong Coal Pty Ltd for the Planning Assessment Commission's consent of the Wallarah 2 Coal Project. It is to be noted that the proceedings in *Wyong* were a judicial review, rather than a consideration of the merits of the project, such that the Court considered the validity of the approval process by the PAC (and whether it involved an error of law), rather than the merits of the decision. In this case, Justice Moore noted that the PAC's approval process was valid in these circumstances and rejected all 10 grounds submitted by the Australian Coal Alliance. Importantly, one of the grounds for the review was failure to consider downstream emission, but this was rejected on the basis that PAC did have regard to the downstream emissions that would arise from the burning of the coal proposed to be produced from this mine and that it had considered what conditions were appropriate.

ASX Corporate Governance Council

The *Corporate Governance Principles and Recommendations Fourth Edition (4th Edition)*, released by the ASX Corporate Governance Council on 27 February 2019, reinforced the importance for listed entities to consider environmental and social risks.

Under recommendation 7.4 the Council recommends that "a listed entity disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks".

The Commentary to this recommendation indicates that:

- an entity's "ability to create long term value for security holders" can be affected by environmental and social risks, so entities should "consider whether they have a material exposure to climate change risk by reference to the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (**TCFD**);"
- if a material exposure is evident, entities should "consider making the disclosures suggested by the TCFD."
- entities which "believe they do not have any material exposure to environmental and social risks should consider carefully their basis for that belief and benchmark their disclosures in this regard against those made by their peers."

One particular source of "environmental risk" noted by the Council relates to climate change, including risks related to the transition to a lower-carbon economy.

This highlights that Australia's legal and business shift towards compliance with emission targets is evident in the wider corporate sphere, rather than just the EPA guidelines or climate conscious court decisions.

Shareholder activism

In 2017 a case was brought in the Federal Court of Australia by shareholders against the Commonwealth Bank of Australia (**CBA**) for a failure to adequately disclose and inform investors of climate change risks in their annual reports. The case was dropped when CBA published its 2017 annual report stating that climate change posed a significant risk to operations, as well as a climate policy statement. The response by CBA shows the risk companies face of adverse shareholder activism regarding to climate change.

Other forms of activism include the report released on 25 March 2019 by environmental campaign group Market Forces, outlining 21 Australian companies that investors should avoid if they don't want to invest in companies that are actively undermining climate change action.

Solutions

Energy and resources companies may mitigate their risks in this changing legal climate by the following:

- ensure that direct and indirect carbon emissions are fully considered for each project;
- set clear procedures for a project's carbon mitigation to show how emissions will be offset;
- give proper consideration to a carbon methodology outlining the project's emissions relative to its peers;
- investment in carbon reduction or sequestration programs may be prudent in light of the shifting legal environment towards climate friendly business;
- possibly moving away from coal and other fossil fuels, towards the commodities that support the 'green technology economy', such as cobalt, nickel, copper and lithium, which are required for electric vehicles, battery technology and utilisation of renewable energy;
- review corporate governance principles to ensure they are in line with the ASX Corporate Governance Council's recommendation 7.4, to emphasise proper consideration of environmental and social risks with reference to the TCFD;
- adequately disclose the effects of climate change in annual reports;
- consider focussing on projects in more favourable jurisdictions that do not have such a focus on greenhouse gas emissions .