

PROXIMO

INFRASTRUCTURE | ENERGY | PROJECTS

PERSPECTIVE

Retiring Asia's coal plants – Gradualism or giveaway?

In:

Power, Renewables

Region:

Asia-Pacific

The Energy Transition Mechanism – an ADB- and Prudential-led scheme to buy and retire early Asian coal capacity – is already being marketed to potential investors. But between NGOs pushing for faster action and powerful vested interests among Asia's national utilities, does the proposal stand a chance?

[The following is an abridged version of an article that appeared on Proximo on 2 September 2021. The full version is available to subscribers and triallists at [this link](#)]

A new venture comprising banks, institutional investors and a DFI wants to buy out large chunks of Asia's coal-fired generating fleet – and retire it early.

The proposal – dubbed the Energy Transmission Mechanism (ETM) - is ambitious, and there is now little argument that the need to reduce the region's carbon dioxide emissions from coal-fired power is pressing, or that coal-power will be particularly difficult to dislodge from Asia's generating fleets.

The ETM raises a vast variety of questions, both big and small, and could lead to a more profound change to the shape of Asia's power sector than 30 years of reform efforts. Between non-governmental organisations (NGOs) pushing for fast action on climate change and vested interests at the national utilities that have powered Asia's impressive growth the proposal will have limited room for manoeuvre.

How the ETM would work

The proposal would involve outside capital acquiring assets in coal-reliant Asian countries, running them for short periods, and then retiring ahead of the end of their useful life. Alongside the acquisition of these old assets, these investors would also fund

the construction of new renewables capacity to replace the retiring coal. The plan would depend heavily on combining different sources of capital in an untested structure

But as Andrew Kinloch of Logie Group, an active adviser in Asia's power and infrastructure sectors, puts it "no amount of structuring can disguise the fact that prematurely retiring assets and building replacements comes at considerable cost and we need to discuss how to share this pain around."

These new ETM entities would be seeded with equity from multilateral and bilateral development banks, or direct equity contributions from developed country governments. While Kanak's proposal does not explicitly mention philanthropic capital and export credit agencies, these players might also make sense as sources of funding.

These contributions would effectively act as first-loss capital, and would be joined by more senior contributions from banks (both commercial and development) and institutional investors. These entities would then use that capital to acquire coal capacity from its existing owners -through a sub-entity called a carbon reduction facility - and build the carbon-free generating capacity that would replace it – through another sub-entity called a clean energy facility. The main targets for the ETM – or at least those in most in need of retiring coal capacity – would be the Philippines, Vietnam, Indonesia, India and China.

The ETM is probably not focused on Asia's independent power sector. As Logie's Kinloch notes "they are often operated to higher environmental standards than plants owned by SOEs [state-owned entities] and host governments will want the concessionary finance for themselves".

Different types of lender will have very different approaches to offtake risk. Chinese policy lenders to Indonesian power projects, notes Logie's Kinloch, typically required full Ministry of Finance guarantees, while Japan's JBIC satisfied themselves with comfort letters, and bond investors have long been comfortable with the government's support for PLN via the Public Service Obligation.

Power sector reform has made limited progress in several ETM target markets for a variety of reasons. Sometimes existing state-owned assets are not commercially viable enough to attract outside capital. And sometimes politics gets in the way: either voters are opposed, or more often workers and management at state-owned utilities can disrupt the reform process.

Banks and institutions will have to make certain that the ETM meets their ESG screens. The ETM is meant to tie host governments/sellers to agreed carbon dioxide retirements, and should these be verified ESG-focused investors might be comfortable investing in coal assets that achieve them. But those investors will be sensitive to accusations that they will be subsidizing the genteel retirement of capacity that drastically cheaper renewables might have rendered obsolete anyway.

Perfecting the pain allocation

Even if the ETM sponsors and lenders can come up with a number that would make everyone happy, there are several big challenges lurking outside the envelope of the structure. The first, and biggest, comprises decommissioning costs. Who deals with the ash ponds left behind when coal-fired plants close? Who pays for the demolition of coal plants? Some existing infrastructure will be very useful to the developers of replacement renewables capacity. A lot of it will not.

But while there is not – yet – any evidence of engagement with all of the questions the market may have, there is an opportunity to refashion Asia's power sector in a way that might limit climate change to the 1.5 degrees warming target. "The time has come to actually do something," suggests Logie's Kinloch. "This is a first concrete proposal and an attempt to put together a workable solution."