

Financial precaution in the lignite industry

Options for securing provisions for lignite mining and for implementing the polluter pays principle

Executive Summary



Rupert Wronski
Swantje Fiedler (FÖS)

Assisted by Karin Schneider



Dr. Dominik Schäuble
Daniela Setton (IASS)

With advice on legal matters by Dr. Cornelia Ziehm, Berlin

Translation kindly supported by Jeffrey H. Michel MSc., Energy Consultant

STUDY ON BEHALF OF



Forum Ökologisch-Soziale Marktwirtschaft e.V.

Schwedenstraße 15a
13357 Berlin
Tel +49 (0)30-7623991 - 30
Fax +49 (0)30-7623991 - 59
www.foes.de • foes@foes.de

IASS Potsdam Institute for Advanced Sustainability Studies e.V.

Berliner Straße 130
D-14467 Potsdam
Tel +49 (0)331-288223-00
Fax +49 (0)331-288223-10
www.iass-potsdam.de • info@iass-potsdam.de

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Under the provisions of the German Federal Mining Act, the polluter pays principle obliges the operators of lignite surface mines to bear the follow-up costs of their commercial activities. The German Commercial Code requires that mining companies have to make provisions to cover these follow-up costs, but not as separate and secure financial means, but only as future payment obligations stated on the balance sheet. The financial means are therefore at the free disposal of the companies until the debts become due. The payment obligations must then be satisfied from current revenues or by liquidation of corporate assets (e.g. power plants, machinery, shares in companies etc.). The estimation of follow-up costs and the calculation of provisions are carried out by the companies themselves and certified in compliance with the guidelines for annual internal audits of large enterprises.

The legal system for provisions for lignite mining outlined here has not been able to guarantee that operators have to bear fully the follow-up costs of lignite surface mining. There are cases (responding to unexpected damaging events, maintaining drinking water quality, etc.) in which follow-up costs have been covered by public funding. Likewise, for future payment obligations, the legal system of provisions cannot guarantee that follow-up costs will be covered by the polluter, as the current legal framework entails several serious risks:

- **Non-transparency of cost estimates and provision calculations**

In 2014, the total provisions for lignite mining of all lignite operators in Germany amounted to EUR 3.2 billion. The underlying internal cost estimates of the companies remain inexplicable for the public and their representatives. It is impossible to verify what detailed costs are reflected in the estimates and whether these costs have been comprehensively compiled. In particular, the very long-term environmental impacts of lignite surface mining, such as those affecting the water regime, could involve costs in future decades that are difficult to predict in precise amount and duration, so that they may be only inadequately taken into account in the provisions. The risk of socialization of these costs is considerable, as exemplified by the current conditions of impaired water quality in the River Spree that are due in part to current surface mines. The question of the extent to which perpetual follow-up costs exist in lignite mining and how comprehensively they may be covered by provisions cannot be answered conclusively on the basis of currently available information.

- **Insufficient corporate liability in the event of bankruptcy**

In the event of bankruptcy, the parent companies of the mining operators could evade responsibility for the follow-up costs under applicable legal requirements, first by the termination of control and profit transfer agreements (BGAV), and secondly by corporate restructuring. In both cases, the state and thus ultimately the taxpayers would be obliged to cover the costs.

- **Interdependencies of nuclear and lignite provisions**

Despite the theoretically independent calculation and reporting of nuclear and lignite provisions, indisputable interdependencies exist in practice. Both nuclear and lignite provisions constitute future obligations that to some extent have to be fulfilled simultaneously. RWE in particular is subject to both of these post-retirement obligations. The risk of bankruptcy is thus increased.

- **Excessive discount rates**

The German Commercial Code prescribes the manner in which discount rates for provisions are derived. An important component is the averaging of the interest rate over the previous seven business years. The rate averaging conducted during a phase of sharp decline of interest rates (as has recently been experienced) results in the estimation of relatively high interest rates, shifting the setting up of provisions partly into the future. This shifting to later points in time increases the associated risks owing to the difficult economic situation of the mining companies.

In light of these risks - which could ultimately result in public funding of follow-up measures - it has become urgently necessary to alter present provision practices in the lignite industry to provide a solid basis for financial precaution by the operators that is impervious to bankruptcy. To this end the present study **recommends the following to decision makers.**

- **Independent evaluation of lignite mining follow-up costs and of provision calculations**

As an **immediate step**, the federal government (possibly together with the affected state governments) should commission an independent study to examine the cost estimates and provision calculations. The main objectives of the investigation would be to achieve detailed transparency of the cost estimates and the calculation of provisions of the corporations, make independent estimates of the follow-up costs of lignite mining, and compare actual practices with the independent follow-up cost estimates. In particular, the long-term and possibly perpetual follow-up costs must be investigated.

- **Enforce the submission of securities as precaution for the case of bankruptcy according to § 56 of the Federal Mining Act**

The state governments should additionally direct the state authorities responsible for lignite mining to demand the submission of securities, also retroactively, as provided by § 56 of the Federal Mining Act (BBergG). Since the enforcement of the submission of securities is at the discretion of the mining authorities, the federal government could likewise revise the Federal Mining Act to make them mandatory.

- **Ensure the liability of the parent companies**

In order to prevent the risks of corporate restructuring and the termination of control and profit transfer agreements, the long-term continuing liability of parent companies should be secured for costs of post-mining landscape rehabilitation. As a first step, the federal government would have to implement a continuing liability law for the lignite industry. Given the current developments in the German electricity sector (economic situation, restructuring of companies, asset sales), further measures on long-term financial precaution will be necessary (see below).

If the study on follow-up costs and provision calculations identifies significant long-term costs and resulting risks for financial precaution, the possibility of securing financial means outside of the respective companies should be carefully examined. Depending on the cost and risk assessment, government intervention for securing the public obligations of mining operators could be substantiated, for example, by the legal institution of a fund to which operators transfer the financial means for rehabilitation. The suitability of specific instruments for ensuring the long-term financial precaution in lignite mining is then to be examined in detail (e.g. external fund, combined internal / external solutions). Within the framework of this analysis, **the following instruments have been found to be principally suitable:**

- The establishment of a **public fund with continuing liability** promises the highest degree of security for long-term financial precaution, since such a solution would provide the best protection in the event of bankruptcy. Such long-term financial precaution would be particularly crucial for the proper restoration of the water regime and for other long-term damages. The public fund could also offer enhanced security for potentially perpetual costs.
- A **combination of internal and external solutions** for short- to mid-term liabilities on the one hand and long-term liabilities on the other appears to be a basically appropriate solution to account for differences in temporal occurrence of follow-up costs. For example, the submission of securities according to § 56 BBergG covering short- to mid-term obligations might be combined with an external fund for long-term liabilities.

Another principle means of ensuring financial precaution by the mining companies would be to establish a **private foundation** such as already exists for hard coal mining. This solution, however, could only be established jointly by political agreement with operators within the framework of a regulated lignite phase-out. The discussion on a lignite foundation has only just begun. Implementation of the polluter pays principle to cover the follow-up costs depends crucially on a durable funding structure for the establishment of an adequate endowment capital. The original operators should not be permitted to transfer their liability risks to the state.

Table 1 summarizes the recommendations with regard to the identified risks and with temporal differentiation (immediate / mid-term). It also identifies the responsible political instances (federal government / state government).

Table 1 Summary of recommendations for financial precaution in the lignite industry

Risks	Possible Instrument	
	Immediate implementation within existing legal structures	Mid-term implementation
Insufficient provisions (including long-term costs)	Independent cost study for verification of the calculation of provisions → commissioned by the federal government and/or the state governments	- Legal framework for transparency and periodic verification of the provisions - Review of discount rate regulations - Security assets, if required
Bankruptcy of mining companies	Examination of the long-term cost risks as part of the independent cost study	- Enactment of a continuing liability law → federal government introduces legislation into parliament - If required, introduction of legal obligation to deposit a security → federal government introduces legislation into parliament - If required, introduction of obligatory security assets
Insufficient (long-term) security of financial assets, e. g., bankruptcy of the parent company	Oblige mining companies to deposit a security according to §56 Federal mining act → state governments direct state agencies	- If required, establishment of a public fund with continuing liability (also in combination with deposit of security) → federal government (and/or state governments) determines on the basis of the cost study - If required, establishment of a private foundation → federal government (and/or state governments) examines options in conjunction with the termination of lignite mining