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JOINT SELECT COMMITTEE ON AUSTRALIA'S CLEAN ENERGY FUTURE LEGISLATION

APPEA Submission

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KEY POINTS

- APPEA supports a national climate change policy that delivers abatement at least cost and facilitates investment decisions consistent with there being an international price on carbon.

- Australia has substantial natural gas resources. Developing these resources for domestic use and for export in the form of liquefied natural gas (LNG) will deliver a significant economic and social return to Australia. The relatively low-cost emissions abatement opportunity offered by the increased use of natural gas means that developing these resources can also deliver significant environmental benefits.

- A number of aspects of the Legislation will raise the cost of meeting Australia's greenhouse gas emissions reduction targets and increase investment uncertainty.

- Significant portions of Australia's emissions are excluded from the scope of the carbon price mechanism established by the Legislation. By virtue of the default carbon pollution cap mechanism in the Bill, sectors directly covered by the mechanism are expected to deliver the entire national emissions reduction burden. This is inefficient and inequitable.

- **With Australia taking action before comparable action is taken by the nations with which we compete, our climate change policy response must maintain the competitiveness of Australian export industries, particularly cleaner global contributor exports (such as LNG), by minimising the costs the industry faces in the absence of a carbon price being imposed on higher-emitting energy sources in customer countries and competitors.**

- The treatment of trade-exposed industries should be elevated to the Act itself rather than handled by regulation.

- Various aspects of the Legislation mean that little certainty about scheme design is provided beyond 2015-16, with almost all key attributes of the scheme, including the treatment of trade-exposed industries, open for review and potential change. This lack of certainty acts as a disincentive to future investment in Australia not just for low emissions technology but across the economy.

- APPEA also recommends a number of amendments to specific areas of the Legislation.

- The Objects of the *Clean Energy Bill 2011* should be expanded to include:

  - offset competitive disadvantage for trade-exposed industries; and
  - replace existing measures no longer required in the presence of a carbon price mechanism.

- Amendments to aspects of the Legislation dealing with designated joint ventures are required to ensure that the upstream oil and gas industry will be able to satisfy its obligations under the Legislation in a manner that does not significantly disrupt the long-established commercial, legal and fiscal operating arrangements that underpin the operation of the industry in Australia.

- Provided a number of key definitions are developed appropriately and in consultation with industry, the proposed Obligation Transfer Number arrangements may offer a relatively low-cost and workable model for dealing with emissions from the use of natural gas. The key issue requiring resolution is the proposed definitions of a "Natural Gas Supply Pipeline" and "Natural Gas Supplier".

- The growth of separate Australian Government and State and Territory Government policies and greenhouse initiatives and their lack of consistency are increasing costs and uncertainty for Australian industry, including the upstream oil and gas industry. The proposed Climate Change Authority should be able to review these additional policies and be able to report on the effectiveness and cost of these policies and how they interact with the mechanism that will be established under the Act.

- The Bill stipulates that changes in surrender restrictions are not to take effect before the beginning of the eligible financial year following the eligible financial year in which the regulations are registered. This means that specified international emissions units may no longer be eligible to be used to meet a person's scheme liability with less than one years' notice. APPEA recommends a provision be included in the Act that regulations prohibiting the surrender of specified international units should not apply where contracts for the supply of those specified international units have already been entered into and that any changes to surrender restrictions should only take effect at least two eligible financial years following the eligible financial year in which the regulations are registered.

- Greater clarity is required around the application of the Legislation to the Joint Petroleum Development Area and Greater Sunrise development.

- The Government should not proceed with the proposed charge for surrendering an eligible international emissions unit and should reconsider the passage of the *Clean Energy (International Unit Surrender Charge) Bill 2011*.

1. INTRODUCTION

The Australian Petroleum Production & Exploration Association (APPEA) is the peak national body representing the Australian upstream oil and gas industry. APPEA member companies collectively produce around 98 per cent of Australia's oil and gas. Further details about APPEA can be found at our website, at www.appea.com.au.

APPEA has been engaged in the greenhouse policy debate since its inception and welcomes the opportunity to provide comment to the Joint Select Committee on Australia's Clean Energy Future Legislation on the Clean Energy Future Legislation (the Legislation), introduced into Parliament on 13 September 2011.

APPEA is also a member of the Australian Industry Greenhouse Network (AIGN), a network of industry associations and businesses that contribute to the climate change policy debate and see value in joint industry action on climate change policy issues in order to promote sustainable industry development[1]. APPEA has contributed to the AIGN submission to the Committee.

In addition to the APPEA submission, a number of APPEA members have made individual submissions to the Committee. This response should be read in conjunction those submissions.

1.1 The role of Australia's oil and gas industry in Australia's climate change policy response

> APPEA supports a national climate change policy that delivers abatement at least cost and facilitates investment decisions consistent with there being an international price on carbon.

Our abundant natural gas resources place Australia in an enviable position to maintain long-term, clean energy security domestically and internationally. Natural gas makes it possible for Australia to meet the world's growing energy needs over the coming decades while incorporating a strategy to curb emissions and address the risk of climate change.

1.2 Design of Australia's climate change policy response

Managing greenhouse gas emissions and meeting growing energy demand requires action by individuals, companies, and governments. This will entail an integrated set of solutions, including increasing efficiency, advancing lower-carbon energy technologies, and supporting effective national and international policies.

Given the importance of competitively priced and reliable energy to global economies and improved living standards, it is essential that policies aimed at reducing greenhouse gas emissions do so at the lowest possible cost.

This requires using an appropriately designed carbon pricing mechanism to impose economy-wide, predictable and transparent costs to shape business and consumer plans and investments. In addition, global participation is critical to reducing costs and risks.

[1] See www.aign.net.au for further information.

The development of Australia's natural gas resources can deliver significant national economic, environmental and social benefits. APPEA will continue to work with all Australian governments to realise these benefits.

1.3 The role of Australia's upstream oil and gas industry in Australia's climate change policy response

Australia has substantial natural gas resources. Developing these resources for domestic use and for export in the form of liquefied natural gas (LNG) can provide significant national economic and social benefits. The relatively low-cost emissions abatement opportunity offered by the increased use of natural gas means that developing these resources can also deliver significant environmental benefits.

APPEA has developed a set of *Climate Change Policy Principles*[2] to underpin Australia's policy response to climate change. A copy of these principles can be found at Attachment 1. They guide and inform APPEA's response to the Legislation.

APPEA's submission has been organised to address specific clauses of the Bills and associated Explanatory Memorandum. Following a number of general comments on the Legislation, the submission focuses on those areas that are particularly important for Australia's upstream oil and gas industry. Section 3 recommends a number of key changes to the Legislation that will improve its operation and seek to ensure greenhouse gas emissions reductions can take place at lower cost to the upstream oil and gas industry and the broader Australian economy.

2. GENERAL COMMENTS ON THE LEGISLATION

As noted in Section 1, APPEA supports a national climate change policy that delivers abatement at least cost and facilitates investment decisions consistent with there being an international price on carbon. A number of aspects of the Legislation will raise the cost of meeting Australia's greenhouse gas emissions reduction targets and increase investment uncertainty:

- significant portions of Australia's emissions are excluded from the scope of the carbon price mechanism established by the Legislation. Worryingly, by virtue of the default carbon pollution cap mechanism in the *Clean Energy Bill 2011*, sectors directly covered by the mechanism appear to bear the entire national emissions reduction burden. This is inefficient and inequitable. Lowest cost emissions reductions are best achieved through a price on emissions imposed on the widest possible coverage of emissions that addresses all greenhouse gases, emission sources and sinks and recognises the widest possible range of credible offsets. The Legislation should ensure the emissions reduction burden is shared equitably across the economy, including those sectors not directly covered by the proposed carbon price mechanism;

- Australia's LNG projects face fierce global competition. Australia's major LNG competitors include Qatar, Indonesia, Malaysia, Trinidad & Tobago, Oman, the United Arab Emirates, Egypt, Equatorial Guinea, Nigeria, Algeria and Brunei. In the future they will include PNG and Russia and could even include the US, on their back of their enormous shale gas developments in recent years. In addition to exporting LNG, the one thing they have in common is that very few are taking any action to put an effective price on carbon and indeed,

[2] See www.appea.com.au/images/stories/Publications/ClimateChange_lores.pdf for further information.

many are likely to be at the bottom of the list of countries who will be taking action in the foreseeable future. All of Australia's major LNG competitors have not taken on binding emissions reduction obligations and do not have policies that place an "effective" carbon price on their LNG exporters. This means that Australia's LNG exporters are amongst the most trade-exposed of all Australian exporters. They cannot pass increased costs on to consumers and any loss of international competitiveness would benefit Australia's international LNG competitors or suppliers of alternative, higher greenhouse gas emitting, energy sources.

- the carbon pricing mechanism will apply well in advance of comparable action being taken by many nations with which the LNG industry competes. In doing so, it exposes the Australian economy to higher production costs than those competitor countries that have not implemented emissions reduction policies. Provisions in the *Clean Energy Bill 2011* impose a price on Australian emissions which is likely to be higher than the prices imposed in other emissions markets (such as the Clean Development Mechanism or the European Union Emissions Trading Scheme). The design in Part 7 of the *Clean Energy Bill 2011* (the Jobs and Competitiveness Program) only partly addresses the adverse impact of the carbon price mechanism on the competitiveness of Australia's trade-exposed industries

  - to address these distortions, APPEA's *Climate Change Policy Principles* recommends, in the event Australia takes action before comparable action is taken by the nations with which we compete, that our climate change policy response maintains the competitiveness of Australian export industries, particularly cleaner global contributor exports (such as LNG), by minimising the costs the industry faces in the absence of a carbon price being imposed on higher-emitting energy sources in customer countries and competitors;

- various aspects of the Legislation mean that little certainty about scheme design is provided beyond 2015-16, with almost all key attributes of the scheme, including the treatment of trade-exposed industries, open to review and potential change. This lack of certainty acts as a disincentive to future investment in Australia not just for low emissions technology but across the economy. The treatment of trade-exposed industries should be included in the Act itself rather than the regulations

  - to have key features of the mechanism potentially changed in the short-term, in many cases before the projects have commenced production, is inappropriate and adds to an already challenging investment environment in Australia for large-scale, long-lived projects.

3. COMMENTS ON THE BILLS AND EXPLANATORY MEMORANDUM

3.1 Treatment of trade-exposed industries (Part 7 of the *Clean Energy Bill 2011*): the role of LNG as a cleaner global contributor

Part 7 of the *Clean Energy Bill 2011* sets out the proposed treatment of trade-exposed industries through the Jobs and Competitiveness Program. APPEA also notes that Part 7 is largely unchanged from the treatment of trade-exposed industries proposed in the former CPRS (with the addition of a number of inquiry functions for the Productivity Commission, considered in Section 3.1.7 below). This means almost all of the key details of the treatment are proposed to be dealt with by regulation rather than in the Act itself.

APPEA recommends the treatment of trade-exposed industries be incorporated into the primary legislation, not relegated to regulations. In particular, the inclusion of the existence of the moderately and highly emissions-intensive trade-exposed categories, their proposed assistance rates and the provision for supplementary assistance for the LNG industry be explicitly stated in the Bills, rather than in regulations.

3.1.1 General comments

Production costs will be higher in the countries that have implemented a price on carbon relative to those that have not.

APPEA has long recommended that measure(s) to deal with this international policy distortion must be a central feature of any emissions trading scheme introduced in Australia.

In doing so, it is important to recall why the trade-exposed industries issue arises at all – that is, the failure of Governments to reach a global agreement on carbon pricing and the consequent implications for industry competitiveness that arise from unilateral actions by any one Government.

With that in mind, APPEA's principal objective in this context is to ensure that the Australian LNG industry does not bear an additional cost impact while ever its competitors are not subject to a similar impost.

The importance of this issue cannot be underestimated: a domestic carbon price mechanism, such as that proposed in the Legislation, will be highly prejudicial to Australia's economic performance without a provision to preserve industry's international competitiveness.

For a number of reasons that will be considered further below, the Bills fail to achieve this outcome and require amendment.

3.1.2 Treatment of the LNG industry under Part 7 of the Clean Energy Bill 2011

Provided it meets the criteria set out in the Bill and associated Explanatory Memorandum, LNG may qualify for an administrative allocation of carbon units to cover up to nominally 66 per cent of emissions in the first year of the mechanism's operation.

This limited and declining assistance fails to secure the ongoing competitiveness of Australian LNG. It also fails to recognise that the exposure of Australian LNG does not decline gradually year on year; rather it is linked to Australia's LNG competitors adopting similar carbon costs.

Australia's LNG industry will be subject to a significant cost burden that is not borne by its overseas competitors. Reducing the international competitiveness of Australia's LNG industry will risk its growth prospects being constrained, reducing Australia's terms of trade and actually risk increasing global emissions as developing countries continue to expand their use of more carbon-intensive fuels.

Support for the LNG industry in the context of a carbon price is not a matter of assisting the industry to transition to low emissions technologies. Arguments raised by some that the industry

can "afford to pay" are economically naïve and fail to recognise the principle maintaining competitiveness by aligning Australia's circumstances with those of its international competitors, and the range of factors which influence investment decisions in the Australian LNG industry. Carbon costs of the kind implied by the mechanism would represent a substantial addition to operating costs for projects that already face significant and ongoing cost pressures[3].

Subjected to a global price of carbon, the international natural gas industry will expand, as a consequence of having 50 to 70 per cent fewer emissions when used in electricity generation compared to the coal alternative. Full permit allocation should be provided until relevant governments negotiate the transition to a world in which emissions from LNG are comparably treated and in a manner that is not disadvantaged relative to international competitors.

As the Minister for Climate Change and Energy Efficiency, the Hon Greg Combet AM MP, noted on 16 September 2011[4]:

> *The atmosphere knows no national boundaries. A tonne of pollution reduced overseas, credibly done, has the same importance as a tonne of pollution reduced in our own economy …*

Yet, the Legislation, as proposed, risks constraining the LNG industry's growth.

3.1.3 Options to provide a more appropriate treatment of trade-exposed industries

APPEA recognises the announcements the Government has made in relation to the treatment of trade-exposed industries. Amendments to Part 7 of the *Clean Energy Bill 2011* could, however, be made to provide for a more appropriate treatment of trade-exposed industries.

APPEA recommends the *Clean Energy Bill 2011* be amended to minimise the costs that the Australian LNG industry faces in the absence of a carbon price being imposed on its competitors. This could be achieved by:

- ensuring an administrative allocation of carbon units to fully offset all additional costs imposed under the *Clean Energy Bill 2011*; and
- removing the proposed allocation 'decay' of 1.3 per cent per year.

3.1.4 Aims and Objects of the Jobs and Competitiveness Program (Part 7, Division 1, clause 143 of the Clean Energy Bill 2011)

APPEA recommends the following amendments to clause 143:

- a new Object should be added to clause 143(2) to reflect that a fundamental principle in designing a carbon price mechanism in the absence of a global scheme must be to ensure that it produces similar production and investment outcomes to those reasonably expected under a global scheme;

[3] For example, a paper prepared by Macquarie Equities Research, *Australian LNG outlook Carbon tax: lots of detail but little certainty* shows that 9 of the world's 14 most expensive LNG projects are based in Australia. It notes on page 2 *"… this added policy uncertainty comes at a time when Australia's high-cost LNG projects were already facing growing international competition, rising cost pressures, acute labour shortages and the persistently high local currency."*
[4] See www.dailytelegraph.com.au/news/sydney-nsw/carbon-brochure-returned-to-climate-change-minister-greg-combet/story-fn7q4q9f-1226138295202.

- clause 143(2)(b) should be reworded to more appropriately reflect the policy principle underpinning this Part of the Bill, that is, the adverse implications for international competitiveness of Australian trade-exposed industries of the actions contemplated by the Legislation. APPEA suggests clause 143(2)(b) be reworded to read *"… to reduce the adverse effects of international competitiveness on such an activity of different climate change policies applying in Australia compared to foreign countries with which persons carrying on such an activity in Australia compete …"*; and

- clause 143(2)(f) should be deleted. Clause 143(2)(f) is focussed on large emitting countries, when the real issue for trade-exposed industries is the action of competitors – this is captured in clause 143(2)(e).

3.1.5 The Jobs and Competitiveness Program (Part7, Division 1, clause 145 of the Clean Energy Bill 2011)

APPEA recommends that clause 145(2) be amended to read:

> *The regulations (or more appropriate, this Part of the Act)* ***must*** *formulate a program (to be known as the* ***Jobs and Competitiveness Program****) for the issue of administratively allocated carbon units in respect of activities that:*

This more appropriately reflects the policy announcement that a program will be a feature of the mechanism.

3.1.6 References to the LNG Supplementary Allocation (paragraph 5.22 of the Explanatory Memorandum to the Clean Energy Bill 2011)

APPEA notes the dot point at paragraph 5.22 of the Explanatory Memorandum sets out the LNG supplementary allocation as follows:

- *LNG projects will receive a supplementary allocation to ensure that they receive an effective rate of assistance at or above 50 per cent.*

APPEA recommends this treatment also be set out in the Act itself, by inserting a new clause 145(3) (and renumbering existing clauses 145(3) and 145(4)) that reads:

- *The Jobs and Competitiveness Program must provide that liquefied natural gas (LNG) projects will receive a supplementary allocation of administratively allocated carbon units to ensure that they receive an effective rate of assistance at or above 50 per cent.*

This more appropriately reflects the policy commitment that the LNG supplementary allocation is a core feature of the mechanism.

3.1.7 Productivity Commission inquiries (Part 7, Division 5 of the Clean Energy Bill 2011)

The provisions outlined in Part 7, Division 5 of the Bill, that will see the Productivity Commission subject the Jobs and Competitiveness Program to a series of ongoing reviews that could fundamentally alter or remove the program in as little as five years after the mechanism is proposed to commence creates significant uncertainty for every trade-exposed industry in Australia, especially for long-lived projects or projects for which investment decisions have been made or are under active consideration on the basis of durable scheme architecture.

With this in mind, APPEA recommends the following amendments to Division 5 (clauses 155-158):

- a new subclause be inserted into clause 155(1) to ensure the LNG supplementary allocation is only reviewed in the review periods mentioned in clauses 155(1)(d) and (e), that is, the LNG supplementary allocation not be reviewed before 2019. This will ensure that the LNG supplementary allocation is reviewed in a period after it has actually commenced operation (it is unlikely that any LNG project will seek to access the supplementary allocation until some of the projects under construction start production, in 2014-15 at the earliest) and after an LNG project has received carbon unit allocations under the LNG supplementary allocation. To review the supplementary allocation before it has even commenced, as currently proposed by clause 155(1), is inappropriate;

- clause 155(2) be amended to include *"(a) the impact of the Act on industries eligible for, or that might benefit from, assistance under the Jobs and Competitiveness Program"*. The current clause 155(2) limits the matters to which the Productivity Minister must refer to the Productivity Commission to those dealing with the Jobs and Competitiveness Program. It would be more appropriate for these reviews to consider the overall impact of the Act on those industries receiving assistance under the Jobs and Competitiveness Program;

- clause 156(2)(b) be reworded to read *"steps taken by persons carrying on emissions-intensive trade-exposed activities towards achieving improvements in energy efficiency and greenhouse gas emissions reductions having regard to the circumstances of the persons carrying on those activities and the prevailing and future carbon price;"*. This would better recognise that in many industries, including LNG, a range of "environmental factors" may affect overall energy use and emissions from a facility. Energy efficiency and emissions efficiency are subjective, are hard to measure and are almost impossible to compare across facilities on a like-for-like basis[5]

  - the practical implementation of this clause in its current form would be problematic given the difficulty in measuring "best practice energy efficiency" in complex systems. There is experience in implementing environmental licence conditions that demonstrates that the use of terms such as best practice energy efficiency is subjective and almost impossible to measure. Often emissions intensity is used as a proxy for energy efficiency – this is misguided

  - the effect of environmental factors on metrics such as emissions intensity/efficiency (for example, the carbon dioxide content of a gas reservoir) mean that it would be incorrect to assume that because a facility has an emissions intensity that is higher than another facility that it is any less energy efficient. Care needs to be taken to not misrepresent emissions intensity as a measure of energy efficiency

  - it is also important to note that the imposition of a price on emissions is not intended to deliver best practice emissions reduction at any cost, but rather to deliver the most efficient level of energy efficiency consistent with the carbon price (particularly the prevailing forward price curve);

[5] These issues were considered in detail in APPEA's submission to the Prime Minister's Task Group on Energy Efficiency. See www.climatechange.gov.au/en/government/submissions/pm-task-group/~/media/submissions/pm-taskforce/papers/127-appea.ashx for further information.

- clause 156(2)(d) should be amended to read *"the extent to which foreign competitors have implemented emissions reduction measures that have an impact that is comparable to the impact of Australian emissions reduction measures …"*. The real issue for trade-exposed industries is the action of competitors;

- clause 156(2)(e)(ii) should deleted. Clause 156(2)(e)(ii) requires that in assessing if a different method (essentially the method recommended by *The Garnaut Review 2011*[6]) should be used to determine assistance under the Jobs and Competitiveness Program, any resulting method must be consistent with the aim and objectives of this Part of the Act. This is overly restrictive. The aim and objects of Part 7 of the Draft Bill define one of the objects being "*to reduce the incentives for such and activity to be relocated in, or relocated to, foreign countries as a result of different climate change policies applying in Australia compared to foreign countries*". This is not consistent with the Garnaut model which is about treatment of trade-exposed activities attempting to model the outcomes likely to emerge in the event a globally comparable emissions price was to exist. If clause 156(2)(e)(ii) was removed this would enable the government/Productivity Commission to consider options which might have a different but appropriate objective. Clause 156(4) should also be amended to consider whether the relevant method is the most effective and efficient means to treat trade-exposed industries; and

- clause 156(2)(g) should be deleted. It does not give effect to the announced policy, which does not cap permit allocations to trade-exposed industries, including new entrants. The ability to access the international market (even with the restrictions contained in the Legislation) to obtain carbon units means that a cap is and will remain unnecessary.

3.2 Objects of the *Clean Energy Bill 2011* (Part 1, clause 3)

APPEA notes that the Objects of the *Clean Energy Bill 2011*, as set out in Part 1, clause 3, have been amended (from the exposure draft) to more appropriately reflect the policy objectives of the Bill and its role in climate change policy development. That said, a number of amendments are still required.

APPEA therefore recommends that the objects of the *Clean Energy Bill 2011* contained in Part 1, clause 3, be expanded to include that it should:

- offset competitive disadvantage for emissions-intensive trade-exposed industries; and

- replace existing measures no longer required in the presence of a carbon price mechanism.

3.3 Point of Liability: treatment of Designated Joint Ventures (various places, primarily Part 3, Division 5 of the *Clean Energy Bill 2011*)

Upstream oil and gas industry projects in Australia are generally undertaken by unincorporated joint ventures (UJVs).

The relationship of the parties to the joint venture is governed by a contract generally referred to as a joint operating agreement (JOA). A JOA generally does not lead to the creation of a legal entity. Under the JOA, the parties appoint an entity, often one of themselves, as operator to undertake joint venture activities on their behalf. All assets of the joint venture are owned jointly by the parties. Though the operator executes the activities that lead to oil and gas production, it

[6] See www.garnautreview.org.au/update-2011/garnaut-review-2011/garnaut-review-2011.pdf for more information.

does not own the oil and gas molecules or the joint venture's assets, except to the extent of its participating interest. Parties have an entitlement and an obligation under the JOA to take in kind their participating interest share of production. The parties' liabilities are several and not joint or collective. Each party is therefore responsible only for its individual obligations. Additionally, JOAs do not exclude foreign entities from being part of an UJV nor do they limit their liability. The model is extremely common world-wide.

The operator, should not be the person liable for meeting liabilities for all of the emissions of a UJV. The liability for acquittal of emissions from joint venture operations should be passed back to each of the underlying joint venture participants in proportion with their participating interests in the joint venture. Similarly, administratively allocated carbon units should be allocated to individual participants within UJVs, again on the basis of their participating interests in the joint venture.

The ability, if agreed by the UJV participants, to "push down" liabilities to each underlying joint venture participant is also essential for the effective operation and administration of Australia's fiscal rules to both Australian and foreign entities. For example, in the case of secondary taxation such as petroleum resource rent tax, the relevant legislation treats each joint venture participant with an interest in the project as the person having its own taxation obligations and liabilities. The taxation rules also require that the participant incurs the expenditures eligible for deduction. In the case of income tax, it is the taxpayer or by election its corporate tax group, that must incur the liabilities.

APPEA notes the *Clean Energy Bill 2011* as introduced into the Parliament, has been amended (compared to the exposure draft) to allow for a "push down", if agreed by the UJV participants, of liabilities for the UJV structures typically used in the upstream oil and gas industry.

A number of further amendments to this section of the Bill are required to ensure that the upstream oil and gas industry will be able to satisfy its obligations under the Legislation in a manner that does not significantly disrupt the long-established commercial, legal and fiscal operating arrangements that underpin the operation of the industry in Australia. APPEA recommends:

- clauses 72(4) and (5) should be deleted. These clauses provide that the Regulator must revoke a joint venture declaration if the Regulator is satisfied that the joint venture does not pass the joint venture declaration test in relation to the facility and must revoke a declaration if an amount of unit shortfall charge payable by a participant in the joint venture remains unpaid more than 3 months after it became due for payment. These clauses therefore provide, in certain circumstances that the operator of a joint venture effectively guarantees the compliance of its joint venture participants should they fail to comply with the Act. This is comparable to requiring a joint venture operator to guarantee the tax liabilities of its joint venturers under the relevant tax acts

    - there is no case for penalising the operator of a UJV because a member of the UJV fails to meet its compliance obligations. In applying for designation as a voluntary joint venture clause 70 of the draft Bill requires the Regulator to make a declaration with respect to the joint venture arrangements. In doing so, the Regulator must consider the "capacity" and "financial resources" of the applicants to comply with the Act. Combined with the general criminal and civil provisions in the Act, clause 70 provides appropriate protections against persons "misusing" the designated joint venture provisions

- the operator is unlikely to consent to UJV designation, if it means it must give payment guarantee for payments over which it has no control. This has the potential to significantly disrupt UJV arrangements in the industry

- the operator does not have control over the disposition or otherwise of the participants in a UJV to consent to a joint declaration. As a consequence, operators are unlikely to be covered in UJVs when a payment results not from a 'joint operation' but rather from statutory provisions for the participant's legal liability

- the effective guarantee (while limited in nature in comparison to the proposed clause 139 statutory guarantee contained in the exposure draft Bill) still cuts across the principle that the operator performs an agreed role on behalf of the other participants and that while all assets of the joint venture are owned jointly by the participants, liabilities are several, rather than joint or collective;

- clause 70 be amended to allow the 'start day' of a declaration made under clause 70 to be permitted to occur on a day after the declaration is made (if so requested by the applicants). Joint venture participants should be entitled to submit conditional applications for a declaration, which are dependent upon whether a relevant transaction (for example, sale of participating interest in joint venture) occurs;

- the Regulator should be obliged to make a declaration under clause 70(3) if the relevant criteria are met;

- guidance be provided as to how "economic benefit" is to be defined under clause 78(3) and what criteria can be used to ensure appropriate flexibility for participants within UJVs. This is important to ensure that the provisions are complementary to the legal and commercial framework within which these structures operate

  - for example, in some circumstances, greenhouse gas emissions may be the appropriate way to determine percentages, especially in situations where a facility is processing varying feedstock from multiple sources. The "lower quality" feedstock may require more processing resulting in the supplier of that feedstock having less economic benefit and a greater responsibility for emissions. The degree to which each joint venture participant is responsible for the greenhouse gas emissions from the facility may be a more appropriate way to determine percentages in this situation;

- as part of improving the flexibility for participants, clause 78 should also allow for the operator to take on 100 per cent of the liability, but only if such an arrangement is agreed by the operator and the other joint venture participants;

- clauses 73 to 79 should be amended to allow, when a joint venture transfers its interests in a joint venture to another person, that the transferee acquire the transferor's participating percentage rather than trigger a new determination. As currently drafted, a joint venturer is exposed to a change in its participating percentage if another joint venturer transfers its interest in the joint venture to another person. In particular, it would appear that upon a transfer, a new determination must be requested. This new determination can apply different criteria to the previous determination (upon which basis an investment decision may be made); and

- it also remains unclear whether persons who are participants for part of an eligible year
  - have any liability at all
  - how clauses 21(2), 76(4) and 77(3) would operate in that case
  - who has the authority to apply for and agree to a redetermination (the transferor or transferee).

  Clarification of each of these issues is required.

3.4 Liable entity: participant in designated joint venture (Part 1, clause 21 of the draft *Clean Energy Bill 2011*)

As currently drafted, clause 21 of the Bill does not address the scenario where there is a change in the participating interest of one or more of the participants in a joint venture during the relevant period (eligible financial year or control days), including where a person becomes or ceases to become a joint venturer during that period. As currently drafted, a person that becomes or ceases to become a joint venturer during the relevant period is not a joint venture 'throughout' the period and therefore has no liability under clause 21. It is also not clear what is the liability of a joint venturer where its participating percentage has changed during the relevant period.

In addition, clauses 21(6) (and clause 80(c)) would appear to mean the liability transfer mechanics are not available to joint venturers in respect of their participating percentage share of emissions liability. APPEA recommends joint venture participants who receive direct liability pursuant to clause 21 should be entitled to use the Liability Transfer Certificate mechanics (considered in more detail in Section 3.6 below) to transfer that liability to other members of its corporate group, in the same way as operators can transfer liability.

3.5 Obligation Transfer Numbers (various places, primarily Part 3, Division 4 of the *Clean Energy Bill 2011*)

Provided a number of key definitions are developed appropriately and in consultation with industry, the proposed Obligation Transfer Number (OTN) arrangements set out in various parts of the *Clean Energy Bill 2011* (primarily Part 3, Division 4) represent a positive simplification of the OTN arrangements proposed under the former CPRS and may offer a relatively low-cost and workable model for dealing with emissions from the use of natural gas. Many of the key aspects of this part of the Legislation have, however, been relegated to regulations.

To achieve a workable outcome in a manner consistent with the policy intent, APPEA recommends the following amendments be enshrined in the legislation:

- the key issue requiring resolution is the proposed definition of a "Natural Gas Supply Pipeline" is critical to the operation of Division 3. Given its importance, APPEA recommends this definition be included in the Act itself and not left to regulations
  - as part of this APPEA welcomes the commitment, contained in the Bill's Explanatory Memorandum at paragraphs 1.202 and 1.203, that specific purpose point-to-point pipelines, such as those used, for example, to transfer unprocessed or processed gas either onshore or offshore to a gas production facility for further processing, will not be captured by the definitions;

- in a similar way, a workable definition for "withdrawal", in relation to natural gas, in Part 1, clause 5, is required, as is a workable definition for when supply occurs;

- the twin definition of "supply" in clauses 5 and 6 is confusing, particularly in light of the changes (from the exposure draft) to clauses 33. APPEA recommends that "natural gas supplier" should be defined to mean "a person who holds title to natural gas immediately prior to its withdrawal from the Natural Gas Supply Pipeline network", and the word "network" should be added after each occurrence of the words "Natural Gas Supply Pipeline" in the Act;

- gas producers should not be required to make an assessment, as is proposed by clause 33(1) as to whether *"it may reasonably be expected that the natural gas is wholly or partly for use by the other person"* in quantifying their liability, particularly given that the gas producers have no control over how the gas is used after it is sold (it will be very difficult to make an assumption that it is not to be "used" by the other person). It is not clear what happens if it is reasonable for a natural gas supplier to expect that the natural gas it not going to be used by the recipient but, notwithstanding, it is ultimately combusted. In addition, if "use" is meant to mean "combustion", then the test should refer to "combustion"

  - the changes to the drafting in clause 33(1) which require "suppliers" to make an assessment of whether gas will be "used" has the potential to cause a preliminary emission number (PEN) to crystalise upstream of the withdrawal point. The Explanatory Memorandum at paragraph 1.129 indicates that transfers within the Natural Gas Supply Pipeline (network) are not designed to create PEN's and specifically indicates that the PEN should materialise when the gas with withdrawn

  - in the event that these changes are not made and upstream producers are required to accept a PEN and pass on (via an OTN) or charge customers carbon costs prior to the gas entering a "gas market" (noting that most gas traded on the east coast of Australia must be traded through a market), due to the inability of market participants to match injection and withdrawal quantities, and having no bi-lateral counter parties, the carbon liability of market participants will not match the volumes withdrawn from the market.

APPEA recommends that further consultation be held with the industry to develop workable definitions to give effect to the OTN provisions set out in the *Clean Energy Bill 2011*.

In addition, APPEA recommends:

- a minimum notice period be included, particularly in clause 51, before the withdrawal of an OTN quotation takes effect, for example, 28 days (which would be consistent with the surrender/cancellation period);

- clause 51 be amended to oblige (by replacing they word *"may"* with *"must"*) the OTN holder to inform the supplier that they are no longer permitted to quote an OTN. The clause as drafted appears to imply that the OTN holder who ceases to be permitted to quote the OTN does not have to inform the natural supplier. This seems to put an unnecessary obligation on the supplier; and

- subclause 56(1) be amended to allow transfers within a corporate group. As currently drafted, liabilities assumed by a person from the quoting of an OTN are not capable of being

transferred within a corporate group (for example, together with the direct emissions liabilities of that OTN holder imposed under Division 2 of Part 3) because the certificate holder cannot satisfy the test in subclause 56(3) that it has been supplied with the natural gas (it is not a recipient).

3.6 Point of Liability: Liability Transfer Certificates (various places, primarily Part 2, Division 6 of the *Clean Energy Bill 2011*)

APPEA recommends a number of amendments to the proposed Liability Transfer Certificate (LTC) arrangements:

- clause 80(c) (and clause 21(6)) be amended in line with the recommendations contained in Section 3.4 above;
- the Regulator should be obliged to issue an LTC under clause 83(3) if the relevant criteria are met;
- clause 89 should be amended to remove the four year minimum. The ability to surrender a LTC earlier than four years after it was issued is limited to 'special circumstances' which, according to the Explanatory Memorandum at paragraph 1.109, *"… are unlikely to include a change of operator or contract, as these changes are normal business practice and are foreseeable by a person at the time of their application for an LTC."* This may restrict a range of appropriate corporate restructuring programs; and
- clause 138 should be deleted. The reasons why a statutory guarantee of the kind contemplated in clause 138 is inappropriate are exactly the same as those applying to the previously proposed clause 139 (proposed in the exposure draft of the *Clean Energy Bill 2011* but removed from the *Clean Energy Bill 2011* as introduced into the Parliament) and the existing clauses 72(4) and (5) considered above.

3.7 Reviews by the Climate Change Authority (Part 22 of the *Clean Energy Bill 2011*)

Despite the agreement of the Council of Australian Governments in November 2008[7] to review, through the *COAG Principles for Jurisdictions to Review and Streamline their Existing Climate Change Mitigation Measures*, the plethora of existing climate change policies in the context of introducing a price on greenhouse gas emissions, there remain, according to the Productivity Commission[8], more than 230 policies and programs in Australia that seek to regulate greenhouse gases.

The growth of separate Australian Government and State and Territory Government policies and greenhouse initiatives and their lack of consistency are increasing costs and uncertainty for Australian industry, including the upstream oil and gas industry.

This cost and uncertainty and the associated sovereign risk, misallocation of resources and deadweight losses to the economy associated with the plethora of greenhouse measures in Australia is significant and growing. Such an outcome runs counter to the Objects of the Bill at clause 3(c)(ii) to take action *"… in a flexible and cost effective way."*

[7] See www.coag.gov.au/coag_meeting_outcomes/2008-11-29/docs/20081129_complementarity_principles.pdf for further information.
[8] See www.pc.gov.au/projects/study/carbon-prices/report for further information.

APPEA therefore recommends clause 288 be amended to include, at clause 288(1)(a)(v) *"… the effectiveness and cost of other State and Commonwealth policies and programs to regulate greenhouse gas emissions and how those programs interact with this Act*". This will allow the Climate Change Authority to include in the scope of its reviews these additional policies and be able to report on the effectiveness and cost of these policies and how they interact with the mechanism that will be established under the Act.

In addition, APPEA recommends clause 288(6) be strengthened to ensure that the Authority undertakes public consultation in a manner similar to that of the Productivity Commission with a transparent process involving discussion papers, draft reports and final reports for public comment.

3.8 How eligible emissions units are surrendered: Surrender restrictions (Part 6, Division 2 of the *Clean Energy Bill 2011*)

The Bill at clause 123(3) stipulates that changes in surrender restrictions are not to take effect before the beginning of the eligible financial year following the eligible financial year in which the regulations are registered. This means that specified international emissions units may no longer be eligible to be used to meet a person's scheme liability with less than one years' notice.

This would be despite many entities having entered into long-term contracts to fund international emissions reduction projects with the intent of creating recognised carbon units. It would also appear to run counter to the general recognition that a carbon unit is personal property (as set out in clause 103 of the Bill). At the very least, it would prevent entities from entering into such arrangements, thereby raising the cost of achieving the emissions abatement targets. It also runs counter to the policy intent of ensuring, as page 22 of the *Securing a clean energy future – The Australian Government's climate change plan* report notes, using the carbon price mechanism as the *"… most environmentally effective and economically efficient way to reduce …"* greenhouse gas emissions.

APPEA recommends this inconsistency be overcome by including in the Act a provision that regulations prohibiting the surrender of specified international units should not apply where contracts for the supply of those specified international units have already been entered into and that any changes to surrender restrictions should only take effect at least two eligible financial years following the eligible financial year in which the regulations are registered.

3.9 Default carbon pollution cap for 2015-16 (Part 2 of the *Clean Energy Bill 2011*)

The default carbon pollution scheme caps set out in clause 17 to apply in the event Regulations dealing with the scheme caps are not made should not set overly aggressive emissions reduction targets for those sectors covered by the mechanism. Clause 17 has the effect of requiring the "covered sectors" to carry all the burden of Australia's emissions reduction effort.

Requiring the scheme cap to be reduced by 38 million tonnes by between 2013-14 and the 2015-16 is the equivalent of imposing a reduction on those sectors covered by the scheme of greater than 10 per cent over the four year period.

This has the potential to result in either a significant amount of imports of international units or the Australian carbon unit price being driven towards or into the price ceiling in the first year of the floating price period. The resulting price volatility will not ensure confidence in the working of the mechanism as it transitions from a fixed to floating price.

APPEA recommends clauses 17 and 18 be amended to give effect to the default caps providing an "upper bound" on future carbon pollution caps set by regulation. This will assist participants in the carbon market greatly in forming reasonable views on future carbon prices, and the development of a liquid forward market. A liquid forward market is imperative for investment in new low-emission electricity generation and forward contracting in wholesale energy markets.

APPEA further recommends, in order to facilitate an orderly and smooth transition to the floating price scheme, clause 17 be amended to ensure the default carbon pollution cap for the eligible financial year commencing on 1 July 2015 is set at no more than 21 million tonnes below the level in 2012-13 and the annual reduction for future years be no more than 7 million tonnes per year.

3.10 Extension to Joint Petroleum Development Area (Part 1 of the *Clean Energy Bill 2011*)

APPEA members are co-venturers in the Bayu-Undan Project, the Greater Sunrise Fields and in other JPDA Production Sharing Contracts containing undeveloped oil and gas discoveries. APPEA members, therefore, have a strong interest in the maintenance and improvement of the international competitiveness of the JPDA as a destination for oil and gas exploration and development investment.

APPEA notes that clause 11 of the Bill extends the Act to the Joint Petroleum Development Area (JPDA) and clauses 26, 27 and 28 adjust a person's provisional emissions number to include a prescribed percentage of emissions relating to activities in the JPDA and/or Greater Sunrise unit area.

The Explanatory Memorandum to the *Clean Energy Bill 2011* at paragraph 11.15 and 11.16, says

> *11.15 The operation of the bill extends to the Joint Petroleum Development Area because Australia is responsible for a proportion of the emissions from this region under the United Nations Framework Convention on Climate Change and the Kyoto Protocol.* ***[Part 1, clause 11].*** *The regulations will specify the percentage of the emissions from facilities in the Joint Petroleum Development Area and the Greater Sunrise Unit Area which are subject to the mechanism. These regulations will specify percentages consistent with Australia's responsibilities under international law.* ***[Part 3, clause 26], [Part 3, clause 27], [Part 3, clause 28], [Part 1, clause 5, definition of 'Australia'], [Part 1, clause 5, definition of 'Greater Sunrise unit area]***
>
> *11.16 The express application of the Act to the Joint Petroleum Development Area — an agreed joint development area under the Timor Sea Treaty [2003] ATS 13 — is consistent with the obligations of Australia under article 4(1) of the Treaty between Australia and Timor-Leste on Certain Maritime Arrangements in the Timor Sea [2007] ATS 12.*

Given the Greater Sunrise Unit Area is governed by multiple international treaties, the imposition of the Bill on emissions from the Unit Area raises issues of jurisdictional authority as between Australia and Timor-Leste. This is particularly relevant given the historical bilateral dialogue between Australia and Timor-Leste regarding the Greater Sunrise Unit Area and the expectation of integrated development of the Greater Sunrise Unit Area.

APPEA recommends the Australian Government consult with the Timor-Leste Government to provide clarity around the application of the Legislation to the JPDA and Greater Sunrise development.

3.11 International Unit Surrender Charge (*Clean Energy (International Unit Surrender Charge) Bill 2011*)

APPEA notes the *Clean Energy (International Unit Surrender Charge) Bill 2011* proposes to impose a charge for surrender of an eligible international emissions unit during the eligible financial years beginning on 1 July 2015, 2016 and 2017 and that the charge will be the amount ascertained in accordance with regulations made under the Bill.

Such a charge would limit the ability of Australian liable entities to access more cost effective international abatement (if available), and would be a detriment to covered industry's global competitiveness. It would also run counter to the policy intent of ensuring, as page 22 of the *Securing a clean energy future – The Australian Government's climate change plan* report notes, using the carbon price mechanism as the *"… most environmentally effective and economically efficient way to reduce …"* greenhouse gas emissions.

APPEA therefore recommends the Government not proceed with the proposed charge for surrender of an eligible international emissions unit proposed by the *Clean Energy (International Unit Surrender Charge) Bill 2011*.

If the Australian Government does proceed with the charge, there are two ways to implement these provisions:

- by seeking to apply a surrender charge on international units with the aim to bring the cost of each international unit up to the price floor. This will be administratively difficult to implement if the desire is to determine the price for each international unit and apply a corresponding charge specific to that particular unit; or

- applying a uniform charge to every international unit, which appears to be the intent of the Bill, will be inequitable and inefficient as it will be based on an estimate of the price for international units. Actual prices could be significantly different depending on types of units, when the units were purchased and the prevailing foreign exchange rates at the time. In addition, applying a uniform charge also raises the question of when this charge will be determined and the later the charge is determined, the more difficult it is for liable entities to forward hedge their requirements – in many cases, entities will choose to buy units months if not years in advance of the eligible financial year.

3.12 Definition of Operational Control (Schedule 1, Part 2, sections 11A, 11B and 11C of the *Clean Energy (Consequential Amendments) Bill 2011* and various parts of the *Clean Energy Bill 2011,* particularly clause 20(7) and clause 21(6))

The amended definition of "operational control" under NGERA set out in sections 11A, 11B and 11C needs to be updated to reflect the changes in the declared joint venture provisions under the *Clean Energy Bill 2011*. The amendments in the *Clean Energy (Consequential Amendments) Bill 2011* still appear to be predicated on the authority to introduce and implement operating and environmental policies.

In addition, insofar as the amended definition of "operational control" is used under the *Clean Energy Bill 2011*, it should reflect both of the exceptions to the starting position that the "operator is liable", that is, in the clauses dealing with designated joint ventures and permitted liability transfers. Related to this, the language in clause 20(7) should be consistent with the language used in clause 21(6) – *"taken not to have had the facility"* compared with *"the facility is taken not to have been under the operational control of"*, and the definition of operational control under the National Greenhouse and Energy Reporting Scheme (NGERS) should be subject to any express statements to the contrary under the *Clean Energy Bill 2011*, for example, clauses 20(7) and 21(6).

3.13 Definition of Joint Venture (Schedule 1, Part 2, item 297 of the *Clean Energy (Consequential Amendments) Bill 2011*)

APPEA notes the *Clean Energy (Consequential Amendments) Bill 2011* proposes a new definition of joint venture that would read *"**joint venture** means an unincorporated enterprise carried on by 2 or more persons in common otherwise than in partnership."*

This leaves open the question of how incorporated joint ventures (IJV), which are used in the industry, are to be treated:

- in an IJV, is it the Government's intention that the operating company or the corporate entity be liable for emissions where these entities are distinct separate corporate bodies?
- in an integrated LNG project that comprises a company or IJV, and a UJV, the boundaries of the entities are not the same as per taxation or under the definition of facility as constituted in the Legislation. Is the intent of the Legislation to deem such a project as one facility or separate facilities as per the different corporate structures existing within the LNG project?

APPEA would welcome clarification on these points.

4. OTHER ISSUES

As noted above, a number of issues are not included in the Legislation. This limits the ability of stakeholders to effectively assess and comment upon the Bills.

While by far the most important of these omissions relates to the treatment of trade-exposed industries and the absence of regulatory detail, there are a number of other important issues not included in the Bills. These include but are not limited to (other submissions will undoubtedly highlight additional issues):

- there appears to be no transparent process for distributing the national abatement commitment between the covered (by the mechanism) and uncovered sectors;
- auction design. The Explanatory Memorandum to the *Clean Energy Bill 2011* notes at paragraph 3.62:

> *3.62 The detailed policies, procedures and rules for the conduct of auctions will be determined by the Minister in a legislative instrument.* ***[Part 4, clause 113], [Part 1, clause 5, definition of 'auction']*** *This will be a disallowable legislative instrument for the purposes of the LI Act and will be finalised following consultation. The Regulator may conduct auctions even when a legislative instrument is not in force but it is intended that a legislative instrument be made.* ***[Part 4, clause 113(9)]***

While APPEA welcomes the commitment to consultation contained in paragraph 3.62, it is vital that the detailed policies, procedures and rules for the conduct of auctions, the principal method for release of carbon units to the market, be known well before the legislation is planned to be passed; and

- international linking provisions.

APPEA recommends all of these issues be the subject of consultation with stakeholders before the Bills are passed by the Parliament.