



The Shell Companies in Australia
GPO Box 872K
Melbourne VIC 3001
Australia
Tel +61 3 8823 4000
Fax +61 3 8823 4109
Internet <http://www.shell.com.au>

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The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Sir

Senate Economic Committee Inquiry on the CPRS draft legislation

Shell Australia appreciates the opportunity to make submissions to the Senate Economics Committee as it considers the exposure draft of the Carbon Pollution Reduction Scheme (CPRS) Bill 2009. Given the magnitude of this policy change, we would have appreciated the time to prepare a more detailed analysis of the Bill and the potential implications for our business for the Committee to consider. We will make a more detailed submission to the Department of Climate Change on 14 April 2009.

Notwithstanding the current economic situation, Shell believes there is urgent need for national and international policy implementation to combat climate change. In our view, it is vital that all governments develop market-based policies and supporting legislation that recognise the need to address both the world's growing energy demand and climate change issues. We, therefore, commend the government for proceeding with the CPRS, and recommend that Parliament reviews the legislation as appropriate and finds the political consensus required to pass the CPRS Bill into legislation. Such an outcome will provide industry with the regulatory certainty to adapt to help combat climate change whilst continuing to contribute to economic and employment growth.

Should you wish to discuss anything further, please contact our GHG Manager Tzila Katzel on +61 (0)3 8823 4201.

Yours sincerely

Russell R Caplan
Chairman

1. Executive summary

1. Shell recognises climate change as a critical global issue. The imperative to limit greenhouse gas in the atmosphere needs comprehensive management of carbon dioxide (CO₂) emissions from the production and consumption of energy. Getting the climate change policy and legislation right is therefore critical to success in reducing Australian and global emissions.
2. Notwithstanding the current economic situation, Shell believes there is urgent need for national and international policy implementation to combat climate change. In our view, it is vital that all governments develop market-based policies and supporting legislation that recognise the need to address both the world's growing energy demand and climate change issues. It is important that industry is provided with regulatory certainty so that it can make the necessary adjustments required to help combat climate change whilst continuing to contribute to economic and employment growth.

2. Emission intensive, trade exposed – a truly dreadful problem

3. Ross Garnaut suggests that policymakers are faced with a “truly dreadful problem” in regard to international competitiveness and trade exposure, particularly where there is no global carbon market.¹
4. In the absence of a global carbon market, designing policy and legislation to minimise carbon leakage whilst maintaining incentives to reduce domestic emissions is difficult and complex. The treatment of Energy Intensive Trade Exposed (EITE) industries in the transition period prior to the introduction of a global carbon market is critical. Inappropriate design could harm Australian industry by shifting economic activity and the carbon emissions associated with this offshore. The challenge is to design policy that provides incentives to reduce emissions whilst minimising this risk. Shell acknowledges the substantial improvements in the policy design in the exposure draft compared with the Green Paper. This demonstrates the value of broad consultation on an issue as complex as this. A continued open and cooperative approach between all stakeholders can help to achieve the best possible environmental and economic outcomes.
5. As an end-game, full auctioning of allowances as proposed by the government is the right approach. Over time the cost of emission allowances is likely to be increasingly reflected in product prices and this will allow a movement towards full auctioning.
6. Full auctioning reflects the principle of “price pass through”. Pass through will establish itself in the economy at different rates. Experience in the EU has shown

¹ Garnaut, Ross (2008) *The Garnaut Climate Change Review: Final Report* Cambridge University Press, Melbourne

that this occurs quickly in the electricity sector, but hardly at all when the product price is established outside the local market.

7. When price pass through does not occur, or when it is slow to appear, the government should continue to allocate allowances for free, otherwise business incurs an unrecoverable cost and is competitively disadvantaged in both import competing and export led markets. Conversely, as price pass through is established, the level of auctioning should rise. Profit neutrality needs to be maintained in order to minimise carbon leakage. Profit neutrality means allowances are allocated free or auctioned depending on the ability of the sector to recover the allowance cost from the consumer.
8. Shell notes the government has incorporated most of the above allowance allocation principles into the design of the CPRS, with the exception of including 100 per cent auctioning. We recommend that the government include legislative provisions outlining the intention to move towards 100 per cent auctioning and ensure that the appropriate legislative provisions are included to ensure all of the CPRS policy principles are included.

3. The proposed EITE assistance policy

9. Shell's operations in Australia are predominantly manufacturing, distributing and selling petroleum products for the Australian market, and production of LNG for export. The government has identified both refining and LNG production as being EITE industries. We are currently working with the Department of Climate Change to define the activities for each of these industries as a first step to determine the rate of assistance they will receive within the EITE assistance programme. It is likely LNG will qualify for EITE assistance at a rate of 60 per cent. As a minimum, Petroleum refining is likely to qualify at a minimum for 60 per cent assistance, but may qualify for 90 per cent assistance. At the 60 per cent assistance level, Australian refineries will be severely disadvantaged compared with large regional refineries that have no ETS.
10. Shell acknowledges the substantial improvements in policy design of EITE treatment, from the Green Paper to the White Paper. Shell notes there is no single measure for determining EITE that can be applied equitably to all industries within the economy. As such Shell supports the provision of options described in the white paper, particularly the inclusion of the value added option.
11. The government issued discussion paper: "*Assessing Emissions Intensity using a value added metric*" explores whether a value-added based emissions intensity metric would be more suitable than a revenue based emissions intensity metric for comparing the relative emissions intensities of different activities across the economy. This paper reflects that on the basis of the value added based emissions intensity metric, refining activity (defined in the paper as "Petroleum and coal products") was ranked fourth in terms of EITE industries, a position Shell agrees with. Refining has a single major input cost (crude oil) and a relatively small refinery margin, hence value added is small relative to total revenue.

12. The definition of value added in the CPRS White paper is in fact a proxy definition and excludes some standard costs (as per the ABS definition). The value added proxy is in fact a reduced reflection from the 'true' value added eligibility measure. This will subsequently effect the overall allocation of assistance.
13. Shell recommends that the ABS definition of valued added be utilised in the EITE assistance programme, for the methodology for establishing eligibility and allocation.
14. Refining as an activity qualifies for the EITE assistance programme. We are currently in discussion with government to define the eligible activity. The activity definition is critical in that it provides the boundaries and acceptable methodologies with which to calculate the extent of assistance. To maintain the competitiveness of the Australian refining industry it is critical that refining as an activity qualify for assistance at a rate of 90%. Assistance at a rate of 60% only is likely to have significant negative impacts on refining viability. Local production would be displaced by imported refined products which would reduce economic activity and jobs in Australia while having no net impact on global emissions.
15. Shell considers that the detail of the EITE methodology needs to be set out in the proposed Bill or accompanying draft regulations. In our view, it is important that the EITE assistance methodology is enshrined in legislation to provide certainty regarding the methodology and process on what is such a critical design element of the scheme.
16. Before the EITE policy can be finalised, the policy and guidance material that has been provided thus far need some clarification. Shell considers the available material does not provide enough detail to enable companies to navigate through the EITE process. For example, it is unclear exactly how some basic calculations will be made, such as how production volume weightings will be applied to emissions and financial data; along with how key issues will be dealt with in the EITE eligibility and permit allocation method. Shell recommends the government include more detail on the treatment of EITE industries in the legislation to reduce this area of uncertainty.
17. Based on our experience of EITE policy and preferred government process, we consider clarification is required on a number of key issues including:
 - what financial costs to include or to exclude;
 - the project boundary definitions (where does a process start and finish);
 - the treatment of indirect emissions; and
 - measurements of sector inputs and outputs.

Providing clarification on the above points and other issues that have been previously raised would help the EITE eligibility process for all involved.

18. Getting the EITE assistance methodology and process right is one of the most important aspects of the CPRS from a business viewpoint. It is important to provide sufficient time for all involved to learn as they go and effectively understand the process. We recommend the government enable sufficient time for companies and officials to work through the EITE process.

4. Implementation of Carbon Trading

19. Shell acknowledges there are concerns about the cost of the current CPRS and in particular the volatility of the carbon market. These concerns have intensified in light of the current global economic downturn. Shell considers the current downturn to be serious but unlikely to be long-term. Therefore, we consider that it should not have a significant impact on the design of a long-term climate change policy.

20. Shell acknowledges the governments drive to minimise volatility in the first five years of the scheme by placing a cap on the price of emission permits. The implementation of such caps should be considered carefully as they can have distorting effects. Shell believes a move to a carbon market without price floors and caps should take place as soon as practicable

5. How to encourage CO2 capture and storage

21. The development of CCS is very important for the world to manage its GHG emissions. Shell considers that Carbon Capture and Storage (CCS) technology is entirely driven by climate change policy and the need to abate greenhouse gas emissions. It is, however, becoming increasingly clear that deployment of CCS technology will not happen sufficiently quickly without additional policy intervention, as a carbon price alone will not provide a sufficient incentive for the large scale commercialisation of CCS in the timeframe required.
22. The current draft legislation enables emissions that are sequestered to be netted out, which means carbon that is transferred to carbon capture and storage (CCS) facilities will not be counted towards the originating entity's gross emissions. This proposal is supported by Shell.
23. In order to accelerate the deployment of CCS, Shell recommends the government provides a greater level of support for CCS demonstration facilities in Australia. The Government's support for the Global CCS institute is a tangible example of the Government's commitment in this area.

Mechanisms to accelerate the development of CCS could include:
 - direct payments (partnership between government and the private sector);
 - hypothecation of funds from allowance auctioning; and
 - differentiated allowance allocation that favours early CCS demonstration projects.
24. Shell also strongly supports the inclusion of CCS in the Clean Development Mechanism (CDM) of the Kyoto Protocol, supported by appropriate and robust verification processes, as the main means of making CCS commercially feasible in countries where emissions will rise most rapidly in the near future.

6. Conclusion

25. Shell views the draft legislation as a good start in the transition from policy to legislation to facilitate implementation of the CPRS. However, the legislation and required regulations are not complete. Continued consultation is required to help achieve the most effective policy design. Which in turn will help achieve the best possible environmental and economic outcomes.

26. Due to the timeframes given, we have concentrated on high-level issues within the CPRS policy papers and draft legislation. A more substantive submission will be submitted to the Department of Climate Change on the 14th April 2009.