



Submission

Senate Standing Committee on Economics

Inquiry into the exposure drafts of the
legislation to implement the Carbon Pollution
Reduction Scheme

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TABLE OF CONTENTS

1.0 EXECUTIVE SUMMARY.....	2
2.0 ABOUT CHEVRON.....	3
2.1 Natural Gas and Global Greenhouse Gas Emissions	3
3.0 THE CARBON POLLUTION REDUCTION SCHEME	5
3.1 Allocation of Emissions Units and Trade Exposed Industry	5
4.0 SPECIFIC COMMENTS ON THE EXPOSURE DRAFT CARBON POLLUTION REDUCTION SCHEME BILL 2009.....	8
4.1 Part 1	8
4.2 Part 2	9
4.3 Part 3	9
4.4 Part 4	9
4.5 Part 8	10
4.6 Part 25	10
4.7 Omissions from the Draft Bills	11
5.0 CONCLUSION	12

1.0 EXECUTIVE SUMMARY

Chevron Australia Pty Ltd (Chevron) welcomes the opportunity to provide this submission to the Senate Standing Committee on Economics inquiry into the exposure draft legislation to implement the Carbon Pollution Reduction Scheme (CPRS).

Chevron supports a climate change policy approach that is transparent, encourages global emissions management, promotes energy security, maximizes energy efficiency and conservation, is measured and flexible, has broad equitable treatment, and enables technology.

Chevron broadly supports the move toward a well designed emissions trading scheme as Australia's primary policy response for regulating greenhouse gas emissions. We see a well designed emissions trading scheme as being a more environmentally effective and economically efficient in delivering lowest cost emissions reductions than the current plethora of add hoc policy responses currently being applied to regulate greenhouse gas emissions.

There are many elements of the CPRS – including banking, acquittal points for domestic gas and greenhouse gas storage, monitoring and assurance provisions and international linkages – which Chevron views as key aspects of a workable emission management scheme. However, Chevron remains concerned that the proposed CPRS fails to adequately address the negative impacts on the international competitiveness of Australia's liquefied natural gas (LNG) industry during the period leading up to a global emissions reduction framework. This is likely to provide a motivation for existing industry to relocate away from Australia and a disincentive for new investment within Australia. By placing additional economic barriers in front of the further development of Australia's LNG industry, it may also lead to a significant increase in global greenhouse gas emissions than might otherwise have occurred.

In this submission we propose a number of changes to the treatment of trade exposed industry which will maintain both the economic incentive for those industries to reduce their emissions and at the same time preserve their ability to compete in international markets.

Chevron is yet to complete its detailed review and consideration of the exposure draft legislation and therefore our comments should be considered preliminary.

2.0 ABOUT CHEVRON

Chevron Corporation, through its subsidiaries and affiliates, operates across the entire energy supply spectrum. Chevron's interests include exploring for, producing and transporting crude oil and natural gas and refining, marketing and distributing petroleum fuel. We also generate electrical power, design and market large-scale energy efficiency solutions and are working toward commercialising the energy resources of the future, including bio-fuels and other renewable energy. Chevron is the world's largest producer of geothermal energy and maintains one of the largest hydrogen transportation fuel infrastructures in the United States of America. Chevron Corporation employees over 59 000 people and its subsidiaries conduct business in over 100 countries. Chevron Corporation is based in San Ramon, California.

In Australia, Chevron is the largest holder of Australia's natural gas resources with our primary interests comprising a one sixth interest in the North West Shelf project, the sole proponent of the Wheatstone Project, an interest in the Browse LNG Project and 50 percent equity owner and operator of the Gorgon Project. Both the Gorgon and Wheatstone Projects will supply LNG to international markets and domestic gas to Australian markets.

The Greater Gorgon area gas resource comprises approximately 25 percent of all the natural gas discovered to date within Australia. Chevron and its joint venture partners, ExxonMobil and Shell, are working toward commercialising this gas resource by establishing a major LNG processing centre on Barrow Island, approximately 60 km off the North West coast of Australia. Ongoing efforts to reduce greenhouse gas emissions from the Gorgon Project have resulted in a reduction in emissions intensity such that the proposed project will be one of the worlds most greenhouse gas efficient sources of LNG. A significant contributor to achieving this world class emission intensity reduction is the proposal to geologically store naturally occurring carbon dioxide contained in the reservoir gas which would otherwise be vented to the atmosphere. The Gorgon Joint Venturer's voluntary commitment to invest more than \$1 billion to reduce the emissions foot print of the Gorgon Project is a clear demonstration of an overall project commitment to tackling greenhouse gas emissions.

2.1 Natural Gas and Global Greenhouse Gas Emissions

The United States Energy Information Administration forecasts global energy demand increase by 50 percent between 2005 and 2030 with the most rapid growth in energy demand projected for nations outside the Organization for Economic Cooperation and Development (OECD). Non-OECD economies in the Asia region account for much of this increase in demand with primary energy consumption forecast to grow from 115 exajoules in 2005 to 251 exajoules by 2030¹. Increasing the use of natural gas provides an opportunity to meet this growth in global energy demand while at the same time limiting the growth in global greenhouse gas emissions.

Natural gas is widely recognized as having around half the life cycle greenhouse gas emissions and reduced emissions of sulphur dioxide and particulates compared to other base load fuels such as coal. Natural gas represents the least greenhouse intensive fuel for base load power generation short of adopting nuclear power. As such, the increased use of natural gas both within Australia and internationally has an important role to play

¹ Energy Information Administration, International energy Outlook 2008, Available from <http://www.eia.doe.gov/oiaf/ieo/emissions.html>

in the drive to reduce the growth in global emissions, particularly in the short to intermediate term.

By way of illustration, the Gorgon Project is planned to produce approximately 15 million tonnes of LNG per year for export to Pacific Basin markets which will result in an additional 5.2 million tonnes of greenhouse gas emissions per year in Australia. The life cycle greenhouse gas emissions associated with the energy produced from the Gorgon Project (that is the emissions within Australia resulting from the production of the LNG and the emissions from the transportation and burning of the natural gas by the end use consumers, for example in Japan and China) will amount to approximately 49 million tonnes per year. This compares to approximately 95 million tonnes of greenhouse gases per year if that energy demand was met from Australian or internationally sourced coal.

The use of LNG from the Gorgon Project to provide energy in Pacific Basin markets will result in approximately 45 million tonnes less global greenhouse gas emissions per year compared to a scenario where coal had been used to meet that energy demand. The emissions benefit from one Australian LNG project, therefore, has the potential impact on global greenhouse gas emissions equivalent to removing two thirds of all the vehicles from Australia's roads.

The use of natural gas also results in significantly reduced emissions of sulphur dioxide and particulates compared to the use of coal. The increased use of natural gas provides a practical opportunity to assist countries like China reduce not only their greenhouse gas emissions, but atmospheric pollutants as well.

Chevron's view is that support for the further development of Australia's natural gas resources both for the domestic and international markets should form part of Australia's policy response to climate change. The CPRS as currently proposed fails to do this by effectively imposing additional costs on Australia's LNG industry.

3.0 THE CARBON POLLUTION REDUCTION SCHEME

Chevron broadly supports the move to a well designed emissions trading scheme as Australia's principle policy response to regulating greenhouse gas emissions. Our preliminary review indicates that the exposure draft Bills deliver much of the policy objectives outlined by the Commonwealth Government in its White Paper of December 15, 2008. However, Chevron remains concerned with the potential loss of competitiveness faced by Australia's trade exposed industry and in particular the disincentive the scheme provides for the further development of Australia's LNG industry.

The requirement for trade exposed industry to purchase emissions units is justified as providing those industries with an economic incentive to reduce their emissions. This justification confuses the process of creating a market by either the auctioning or allocation of emissions permits, with a firm's economic motivation to reduce its emissions which is provided by the prevailing price of an emissions unit in the market. Auctioning or allocating emissions units is a choice about how to establish the market, and only effects the functioning of that market where the cost of purchasing those units can be passed on to a firms customers. Where these costs can not be passed on the choice between auctioning and allocation does not effect the functioning of the market nor the ability of a particular firm to reduce its emissions. Requiring trade exposed industries, such as LNG, to purchase emissions units creates additional costs to those industry without increasing the economic motivation for that industry to reduce its emissions.

Part 8 of the draft Carbon Pollution Reduction Scheme Bill 2009 states that one of its objectives is to 'reduce the incentives for such an [emission-intensive trade-exposed] activity to be located in, or relocated to, foreign countries'. Chevron submits that this objective should be to "remove" rather than "reduce" the incentive for firms to relocate from Australia. The acknowledgement in the draft Bill that under the CPRS there should remain some incentive for firms to relocate from Australia is a concern to Chevron.

We note that the draft Bill does not contain the provisions that give effect to the Governments stated policy around the treatment of trade exposed industry. Rather the draft Bill provides that these issues be dealt with by Regulation. This is in marked contrast to how similar important issues dealing with the allocation of emissions units to coal fired power generators and reforestation projects are dealt with in Parts 9 and 10 of the draft Bill. Given the importance of trade exposed industry to the Australian economy, key components of policy dealing with trade exposed industry should be addressed in the legislation.

3.1 Allocation of Emissions Units and Trade Exposed Industry

The Government has proposed that a large proportion of Australian emissions units be auctioned in order to promote allocative efficiency and price discovery.

The auctioning of emissions units will expose domestic consumers to the price of the embedded emissions in domestically sourced products and services they purchase. This is achieved by allowing firms trading in the domestic market to pass on the costs of purchasing emissions units to the degree their products are competitive with respect to embedded greenhouse gas emissions. This ensures that emissions abatement opportunities such as switching to alternative products or improved energy efficiency are

embraced by sectors in the economy such as households that do not have a direct acquittal liability.

The ability to pass through these costs ensures that Australian industry supplying the domestic market is exposed to the full economic incentive to reduce emissions but without incurring a net overall increase in costs (provided the firm is selling a product that is competitive in light of its embedded greenhouse gas emission).

This is in contrast to the situation faced by many trade exposed industries who supply products where prices are set on international markets. These industries are unable to pass through the additional cost of having to purchase emissions permits. The design of the CPRS partially addresses the imposition of additional costs on these industries by the limited administrative allocation of emissions permits to some industries. However it remains the case that many industries competing in international markets will be forced to absorb the cost of purchasing a significant volume of emissions permits, undermining the ability of these industries to compete in international markets.

In effect Government has designed a scheme where all industries included in the coverage of the scheme, are exposed to the same economic incentive to reduce emissions. However trade exposed industries are being required to adsorb an additional cost associated with purchasing emissions units, while industries supplying domestic goods are able to pass this cost on to their customers. In effect the requirement for trade exposed industry to absorb the cost of purchasing emissions units has the same economic impact as an additional tax on production without changing the economic incentive for that industry to reduce its emissions.

Chevron proposes that this could be addressed by:

- Increasing the notional volume of emissions units for the administrative allocation of permits to trade exposed industry in the early years of the scheme needs from the current 25% (excluding agriculture) to as much as 40%.
- Removing the emissions intensity test and basing the eligibility for an allocation of permits solely on the level of competition each industry faces from nations yet to embrace comparable emissions constraints and the ability of the Australian firms in that industry to set international commodity prices. In order to maintain the competitiveness of Australia's export and import competing industries, the emissions unit allocation should be set at a level in excess of 95% of the industry's historical emissions intensity per unit of production.
- If emissions unit allocation is to remain subject to an emissions intensity test, the metric used to determine intensity should be changed to a metric which considers the impact on an industry's cost structure. Chevron has consistently argued that a more equitable test by which to determine permit allocation should be the impact of the CPRS on an industry's 'Intermediate Business Inputs' (operating and labour costs) or the 'Net Value at Risk' (the ratio of intermediate business inputs relative to value added).
- Regardless of the methodologies adopted, emissions units should be allocated to those industries such as LNG that could potentially facilitate a net global reduction in greenhouse gas emissions. Chevron recognises that the allocation of emissions permits would be a transitional arrangement until a global emissions reduction framework is in place.
- Alternatively, if a 'Revenue' based test is to remain, then the loss of international competitiveness faced by Australian industry could be limited by reducing the

current 2000 tonnes per million dollars of revenue threshold to some level below 1000 tonnes per million dollars of revenue. That is all firms with an emissions intensity of greater than 1000 tonnes per million dollars of revenue would receive a 95% or higher emissions unit allocation based on historical levels of emissions intensity.

- The 'value add' eligibility test as currently proposed disadvantages those industries that employ capital (or labour) to create value. This is of particular concern for capital intensive industries such as LNG. It also fails to consider the impact of resource rents, such as the PRRT on a firms operating cost structure. If the 'value add' eligibility test is to remain then it should be re-defined as revenue, less intermediate business inputs, less labour costs, less resource rents, less depreciation, less amortization.
- The proposed 1.3% annual reduction in emissions unit allocation simply imposes an increasing cost on large facilities. It provides no further economic motivation for firms to reduce their emissions. Annual efficiency improvements are extremely difficult and prohibitively expensive to achieve in the LNG industry where plants have an effective life span of 30 – 40 years. This is further compounded by the natural production decline from the natural gas reservoirs which requires an increase in the energy and emissions to produce a given volume of product. The arbitrary reduction in annual permit allocation should be removed.

Importantly these changes would not impact upon the economic incentive of industries receiving an allocation of emissions units to reduce their emissions. As discussed above this economic incentive is provided by the industries marginal cost of abatement and the prevailing emissions price. Consequently these changes would not impact upon the overall level of emissions reduction achieved across the economy.

4.0 SPECIFIC COMMENTS ON THE EXPOSURE DRAFT CARBON POLLUTION REDUCTION SCHEME BILL 2009

The comments contained in this part of our submission relate to exposure draft of the Bills delivery upon the stated policy objectives contained in the Carbon Pollution Reduction Scheme White Paper of December 15, 2008. These comments do not extend to the changes that would improve the CPRS in line with the issues raised earlier in this submission.

Chevron is concerned that the significant components of the CPRS policy, dealing with emissions-intensive trade-exposed industry, has been left out of the draft Bills and are proposed to be dealt with by regulation. The design of the CPRS as it relates to trade exposed industry should be modified so as to ensure that it does not provide an incentive for industry to relocate from Australia and that a positive investment climate is maintained toward future investment in Australia. These changes should then be reflected within the body of the legislation.

4.1 Part 1

Section 3 – Objects

The Objects contained in the exposure draft Bill should extend to a brief overview of how it is proposed to achieve those Objects. Clause 3(4)(b) should be deleted and a new Clause 3(5) inserted.

- (5) The fourth object of this Act is to ensure that emissions reductions are achieved in a flexible manner and at the lowest possible cost to the Australian economy. This will be achieved by:
- i. imposing a consistent market price on greenhouse gas emissions across as much of the Australian economy as practicable;
 - ii. by facilitating the international trade in credible and verifiable emissions units;
 - iii. by addressing trade competitive distortions during the period prior to a global emissions reduction framework that imposes comparable emissions costs on all goods and services; and

positioning the CPRS as the principle policy response used to regulate greenhouse gas emissions.

Section 4 – Simplified Outline

Dot point six should be revised to reflect the use of Obligation Transfer Numbers.

Subject to the quotation of an Obligation Transfer Number, a person who imports, producers or supplies eligible upstream fuel must surrender

Dot points eight, nine and ten could be read as being contradictory. They should be revised to reflect that a significant portion of Australian emissions units will be allocated as opposed to auctioned and that emissions units issued at a fixed charge (safety valve) would be in excess of the scheme cap.

- Australian emissions units will be issued as a result of an auction or by administrative allocation by the Australian Climate Change Regulatory Authority at no charge. The national scheme cap limits the number of Australian emissions units issued as a result of these processes.
- Some additional Australian emissions units may be issued by the Australian Climate Change Regulatory Authority for a fixed charge.

Section 5 – Definitions

recognized transformation

The transformation of natural gas to liquefied natural gas does not reflect the reality that production of liquefied natural gas is highly integrated from a process perspective to the

production of natural gas for the production of LNG. One process cannot exist without the other and there are no opportunities to substitute alternative inputs and outputs between the steps in the LNG production. Nor is there any storage or stockpiling between the natural gas production and LNG processing. Chevron proposes that the definition be amended to read as follows:

- (d) the transformation of natural gas to liquefied natural gas, including the production of natural gas for the purposes of that transformation.

4.2 Part 2

Section 14 and 15

In both sections 14 and 15 reference is made to: major economies; advance economies; and voluntary action in setting the National scheme cap and the National scheme gateway. Given the importance of the scheme cap and gateways the Bill could be improved by having these terms defined.

4.3 Part 3

Division 4 and 5

It would appear that in order to avoid incurring a liability for the eventual burning of eligible upstream fuels exported from Australia the international purchaser of those fuels will have to quote an Obligation Transfer Number (OTN). Requiring persons (firms) located outside Australia to quote an OTN for goods exported from Australia adds a regulatory burden to a large number international based firms and may provide a barrier to the export of Australian fuel products.

The requirement for export purchasers of eligible upstream fuels to quote an OTN appears unreasonable and unnecessary.

This might simply be addressed by modifying the definition of “person” to include a person undertaking activities within Australia. That way a producer only incurs the liability from the end use of that fuel if it is sold onto an Australian user.

Section 68 – Quotation of Bogus OTN

Chevron submits that the requirement of an eligible upstream fuel supplier or supplier of synthetic greenhouse gases to confirm that a recipient has a valid OTN by reference to the OTN Register places an unnecessary regulatory burden on the supplier and proposes that clause 68(2) should be deleted.

4.4 Part 4

Section 82 – Simplified Outline

Chevron submits that dot point two be amended as follows to reflect the fact that a significant portion of Australian emissions units will be administratively allocated:

- Australian emissions units will be issued as a result of an auction or by administrative allocation by the Australian Climate Change Regulatory Authority at no charge.

Section 89 – Issue of Australian emissions units for a fixed charge

The table included in Section 89 of the draft bill might be better off being placed in the Regulations to accompany the Act. That way if government decided that it wished to extend the period of the price cap it could be done without having to amend the legislation.

4.5 Part 8

Section 165 – Objects

Chevron submits that the objects under Clauses 165(b) and (c) should be amended to replace the words “reduce the incentives for such an activity to be located in, or relocated to, foreign countries” with “remove the incentives ...” as follows:

The objects of this Part are:

- (a) to enable the identification of activities as emissions-intensive trade-exposed activities; and
 - (b) to remove any incentive through the introduction of the CPRS for such an activity to be located in, or re-located to, foreign countries.
- until such time as is no longer warranted, having

Section 165 to Section 173

The draft Bill remains silent on the key attributes of the White Paper in relation to the treatment of emissions-intensive trade-exposed industry, deferring to a program to be formulated in the regulations. Given the significance of this component of the CPRS policy, a high level framework should be contained in the Bill with only matters of procedural detail to be left for the regulations.

A similar level of detail to that provided in Parts 9 and 10 of the draft Bill dealing with coal fired power generation and reforestation projects should be provided in Part 8 dealing with emissions-intensive trade exposed industry.

4.6 Part 25

Section 360 – Appointment of expert advisory committee members

The prohibition on persons employed by a liable entity from being eligible for appointment to an expert advisory committee may prevent effective industry representation on these committees. Chevron proposes the deletion of Clause 360 (5) and the amendment of Clause 360(4) as follows:

- (c) a director, officer or employee of another person who, at that time, is, or is likely to be, a liable entity for the eligible financial year in which that time occurs.

This would have the effect of preventing persons associated with a liable entity from Chairing the expert committee or holding a majority of positions on that committee.

4.7 Omissions from the Draft Bills

In addition to the matters dealing with trade exposed industry the following Policy objectives expressed in the White Paper appear to have been omitted from the draft Bills:

- The Bills do not provide for a transparent process to determine the allocation of the national emissions commitment between the CPRS scheme cap and the sectors of the Australian economy not covered by the CPRS
- The design and function of the auction process by which the government proposes to allocate a significant portion of emissions permits.
- How the prohibition on the export of Australian emissions units is proposed to be undertaken. Please note that Chevron does not support the prohibition on the export of emissions units from Australia.

5.0 CONCLUSION

Chevron has identified a number of areas where the legislation could be improved and would strongly encourage the inclusion of provisions dealing with maintaining the international competitiveness of Australia's trade exposed industry, such as LNG, as opposed to having this outlined in the supporting regulations.

Notwithstanding the above and Chevron's general support for the move towards emissions trading, Chevron remains concerned that the CPRS as currently proposed will significantly impact the international competitiveness of Australia's trade exposed industry. This is of particular concern for the future development of Australia's LNG industry which has the potential to facilitate a significant reduction in global greenhouse gas emissions.