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

Email: economics.sen@aph.gov.au

Dear Sir/Madam

Alcoa of Australia Submission:
Carbon Pollution Reduction Scheme (CPRS) Bill 2009

Alcoa undertakes several Emissions-Intensive Trade-Exposed (EITE) activities in Australia through operation of Australia's largest integrated aluminium business. This network includes bauxite mines, alumina refineries and port infrastructure in Western Australia; aluminium smelters, a rolling mill, power station and port facilities in Victoria and a rolling mill and Australia's largest aluminium recycling plant in NSW. Alcoa has also focused on a global response to the challenge of climate change for many years. These factors ensure the potential development of an emission trading scheme in Australia is of great significance to Alcoa.

Alcoa has long recognised the importance of responding to climate change and provided it is done in a way that addresses the environmental challenge while strengthening the Australian economy and preserving the jobs and social benefits that spring from Australian export industries, Alcoa supports the introduction of emissions trading in Australia. This concept has guided Alcoa of Australia's contribution to the CPRS public debate including our detailed responses to the Garnaut review process and the Government's CRPRS Green Paper, both of which are publicly available via the following links to Alcoa Australia's website.

Green Paper Submission:
http://www.alcoa.com/australia/en/pdf/Alcoa_submission_CPRS_GreenPaper_Sept08.pdf

Garnaut ETS Discussion Paper:
http://www.alcoa.com/australia/en/pdf/Garnaut%20Review%20-%20Alcoa%20response.pdf

In relation to the specifics of the CPRS Bill; much of the detailed policy design with potential for significant impact on Alcoa's Australian operations has been left for inclusion in subsequent Regulations. Consequently our comments at this time are of a more general nature and arise primarily from review of the CPRS White Paper and related documents.

Notwithstanding the significant and constructive consultation undertaken as part of the CPRS development phase, Alcoa believes there are a number of key changes that need to be made to the CPRS in order for it to be effective in Australia. In particular these changes are necessary to ensure EITE industries do not suffer unsustainable international competitiveness reductions that will eventually lead to carbon and jobs leakage to low cost centers in other countries. In summary the minimum changes Alcoa believes to be necessary are:

I. Australian EITE industries should receive a free permit allocation equivalent to at least 90% of their direct emissions obligations (including alumina refining, aluminium smelting and aluminium rolling operations);

II. The same (90% permit allocation to EITEs) principle should apply to indirect emission obligations. Alternatively, inequities in the proposed calculation of the Electricity Allocation Factor must be rectified to avoid unsustainable impacts on the Victorian aluminium smelters;

III. Erosion of EITE permits should not occur before international competitors are subject to comparable carbon costs

These points are described further as follows - parts of the following have drawn on the submission prepared by the Australian Aluminium Council of which Alcoa of Australia is a member.

<u>Australian EITE industries should receive a free permit allocation equivalent to at least 90% of their direct emissions obligations.</u>

Under the CPRS, even the most emissions-intensive, trade-exposed activity would only receive an initial permit allocation of 90% of the industry average emissions for that activity. For activities that are highly emissions intensive, such as much of the alumina and aluminium industry, the obligation to purchase the remaining permit gap is a significant cost. This is then exacerbated if parts of the sector receive only 60% initial permit allocation and others, such as bauxite mining, receive 0% initial allocation.

A simple example can show the potential detrimental impact on profitability. A hypothetical integrated alumina and aluminium business operating in Australia during 2008 (say with around 2Mt alumina production and approx 500,000t aluminium production) would likely have experienced an overall 20% – 25% reduction in profitability had it been operating under the CPRS as outlined in the white paper. Some individual facilities in this hypothetical business would have experienced an even higher a reduction in net operating profit of around 30% to 50% during 2008.

<u>Very few trade exposed businesses could sustain such a large impact ahead of its international competitors.</u>

The importance of initial permit allocation calculations has increased further since release of the recent EITE Guidance Paper. There are elements of all industrial processes, such as alumina refining, aluminium smelting and aluminium rolling, that are not proposed as part of the ‘defined activity’ and therefore require the purchase of permits. This includes transport of raw materials and final product, materials handling prior to and after the activity, treatment of residues and waste and potentially other factors. The industry cannot operate without these other activities (and the emissions associated with them) yet they are not captured under the activity definition that receives an allocation of permits.

Inequities in the proposed calculation of the Electricity Allocation Factor must be rectified to avoid unsustainable impacts on the Victorian aluminium smelters.

An electricity allocation factor of one tonne of CO_2 equivalent for each megawatt hour of electricity is proposed in the CPRS to cover the modelled increase in electricity costs. However, Alcoa's experience in the Victorian energy market is that this modelled estimation of carbon intensity and price will significantly underestimate the real impact.

The CPRS proposal acknowledges that very large electricity users (such as aluminium smelters) have no flexibility to source electricity from other sources, or reduce emissions for that electricity, under existing contracts. However, it assumes that any new contract would allow the modelled factor ($1tCO_2$/MWh) to be achieved, or reflected in the contractual arrangements. Because this will not be achieved in Victorian long-term power contracts, the two Victorian aluminium smelters would be exposed to a substantial increase in electricity costs that would not be matched with an ongoing permit allocation. This may deliver an outcome that is far removed from the policy intent to provide 90% assistance for CPRS-driven power price uplift.

Because the Victorian aluminium smelters would only be able to secure long-term power contracts with full carbon cost pass through, they would be required to pay a carbon cost for the power they receive at around $1.22tCO_2$/MWh. Therefore, their initial starting allocation for indirect emissions would effectively be reduced from 90% assistance to 74% assistance. The potential cost impacts of this shortcoming are significant enough to quickly threaten the viability of the two Victorian aluminium smelters.

This significant issue is readily resolved by allowing for the very large electricity user provision to also apply to new contracts. In applying this change the EITE in question could be required to demonstrate that no practicable, lower carbon intensity, alternative power supply was available.

Erosion of EITE permits should not occur before international competitors are subject to comparable carbon costs

The CPRS proposes that even where an activity receives a permit allocation under the EITE provisions, the allocation of permits will decay by 1.3% per annum. The aluminium industry will therefore have to purchase an ever-increasing quantity of permits as the scheme proceeds. This increasing permit gap will combine with the expected increase in the permit price to lead to significantly escalating costs as part of the scheme. This will be a disincentive for investment in new facilities, expansion of existing facilities and sustaining investment to maintain the competitiveness of current facilities.

A central flaw of the proposed CPRS is that it anticipates global action in the near future and pre-determines a reduction in the measures to maintain competitiveness of Australian industry (permit decay) based on the assumption that global action will occur. In forcing Australian industry to accept the risk of that action occurring, the CPRS establishes a perverse incentive for other countries not to take action.

If there was a link in the Australian scheme between the rate of global action and the relaxing of treatment of Australian industry then there would be far less investment risk for Australian industry and a clearer incentive for other countries to join the abatement effort.

Alcoa also believes the CPRS should not be viewed in isolation from other parts of the Federal Government's climate change response strategy, such as the Expanded Renewable Energy Target (RET). In this regard Alcoa believes it is essential that exemptions from the very costly obligations of the expanded Renewable Energy Target (RET) be provided for the most electricity intensive EITE industries

In calling for these changes Alcoa well recognises there is a need to respond to climate change imperatives and has not shirked this challenge. The following examples illustrate Alcoa's willingness to take voluntary action in relation to climate change:

- Globally Alcoa set an ambitious target to reduce its 1990 direct greenhouse gas emissions by 25% by 2010 – this target was reached in 2003 and we are now operating at around 36% below the 1990 benchmark.
- Alcoa's Australian aluminium smelters have reduced direct greenhouse gas emissions per tonne of product by 61% since 1990
- Alcoa's Australian alumina refineries are amongst the most efficient in the world and have still been able to reduce greenhouse gas emissions by per tonne of product by 12% since 1990 levels.
- Our aluminium rolling businesses have reduced direct emissions by 21% from 1990 levels

Alcoa of Australia appreciates the Parliament's commitment to consultation over all aspects of the CPRS and would be happy to provide additional information if required.

Yours sincerely

Tim M'Auliffe

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