



4 June 2009

Mr John Hawkins  
Committee Secretary  
Senate Standing Committee on Economics  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

(via e-mail to: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au))

Dear Mr Hawkins

**RE: SENATE STANDING COMMITTEE ON ECONOMICS  
INQUIRY INTO THE CARBON POLLUTION  
REDUCTION SCHEME BILL 2009 AND RELATED BILLS:  
APPEA COMMENTS**

The Australian Petroleum Production & Exploration Association (APPEA) welcomes the opportunity to provide comments to the Committee's *Inquiry into the Carbon Pollution Reduction Scheme Bill 2009 and related bills*. This submission follows on from APPEA's submission to the Committee's earlier *Inquiry into the Exposure Drafts of the Legislation to implement the Carbon Pollution Reduction Scheme*.

APPEA, and its members, are committed to working towards a profitable, safe, environmentally responsible and socially responsible oil and gas exploration, development and production industry. Governments need to continue to recognise that greenhouse policies, including any consideration of an emissions trading scheme, such as that proposed by these Bills, must allow Australian industry to maintain its international competitiveness.

With that in mind, APPEA's submission offers a range of recommendations to improve the package of legislation and in particular the treatment of Australia's liquefied natural gas industry as a trade-exposed industry.

If you have any queries on any of the issues raised in our submission, please feel free to contact Damian Dwyer, Director – Energy Markets & Climate Change via telephone on 6267 0902 or via e-mail at [ddwyer@appea.com.au](mailto:ddwyer@appea.com.au).

Yours sincerely

A handwritten signature in blue ink, appearing to read "Mark McCallum". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Mark McCallum  
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**SENATE STANDING  
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ECONOMICS *INQUIRY INTO  
THE CARBON POLLUTION  
REDUCTION SCHEME BILL  
2009 AND RELATED BILLS***

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APPEA Submission

JUNE 2009

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## 1. INTRODUCTION

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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](http://www.appea.com.au).

### 1.1 Introduction

APPEA has been engaged in the greenhouse policy debate since its inception and has, for example, participated in every major consideration of emissions trading schemes in Australia, commencing with the Australian Greenhouse Office discussion paper series in 1999 and including, more recently, the work of the States and Territories through the National Emissions Trading Task Force from 2005 to 2008, the work of the Prime Ministerial Task Group on Emissions Trading in 2006 and 2007 and the work of the Garnaut Climate Change Review in 2007 and 2008.

With that in mind, APPEA welcomes the opportunity to provide comment to the Committee's *Inquiry into the Carbon Pollution Reduction Scheme Bill 2009 and related bills*. This submission follows on from APPEA's submission to the Committee's earlier *Inquiry into the Exposure Drafts of the Legislation to implement the Carbon Pollution Reduction Scheme*.

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<sup>1</sup>. 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 with submissions from individual APPEA members.

### 1.2 The role of Australia's oil and gas industry in Australia's greenhouse response

APPEA, and its members, are committed to working towards a profitable, safe, environmentally and socially responsible oil and gas exploration, development and production industry.

Governments need to continue to recognise that greenhouse policies, including any consideration of an emissions trading scheme, such as that proposed by these Bills, must allow Australian industry to maintain its international competitiveness.

As part of its commitment to addressing greenhouse issues, APPEA was an original signatory to the Greenhouse Challenge Program<sup>2</sup> in 1996. Greenhouse Challenge (now Greenhouse

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<sup>1</sup> See [www.aign.net.au](http://www.aign.net.au) for further information.

<sup>2</sup> Greenhouse Challenge Plus is designed to reduce greenhouse gas emissions, accelerate the uptake of energy efficiency, integrate greenhouse issues into business decision-making and provide more consistent reporting of greenhouse gas emissions levels. The APPEA Chief Executive is currently the Industry co-Chair of the Industry-Government Greenhouse Partnership Committee, that provides a forum for consultation on the key issues impacting on Greenhouse Challenge Plus and to ensure the effective development and operation of the program. (see [www.environment.gov.au/settlements/challenge/members/iggpc.html](http://www.environment.gov.au/settlements/challenge/members/iggpc.html)) for further information. On 12 May 2009, the Government's response to the Strategic Review of Australian Government climate change programs confirmed the Greenhouse Challenge Plus Program will cease on 1 July 2009 (see [www.environment.gov.au/minister/wong/2009/wilkinsresponse.html](http://www.environment.gov.au/minister/wong/2009/wilkinsresponse.html) for further details).

Challenge Plus) members from the upstream oil and gas industry have abated over 22 million tonnes (Mt) of carbon dioxide equivalent (CO<sub>2</sub>-e) since that time. Overall, emissions from the upstream oil and gas industry account for less than 4 per cent of Australia's total emissions.

APPEA aims to work with governments and other stakeholders to achieve credible industry actions and governmental greenhouse policies that address greenhouse concerns in an economically viable way, including ways to maintain international competitiveness. As part of this, the upstream oil and gas industry's *Greenhouse Response Strategy* is a public statement, released in 2003, of the industry's approach to greenhouse policy. A copy of the APPEA *Greenhouse Response Strategy* can be found at **Attachment 1**<sup>3</sup>.

In addition, the industry, in 2006, embarked on the development of an Upstream Oil and Gas Industry Strategy. Led by APPEA in consultation with State, Territory and Australian Governments, the objective of the Strategy is:

*... to ensure the value of Australia's oil and gas resources to the Australian people is maximised, petroleum energy security delivered and long-term sustainability of an Australian oil and gas industry assured.*

The Strategic Leaders' Report, *Platform for Prosperity*, was released in April 2007<sup>4</sup> and provides an overview of the opportunities and challenges facing the Australian upstream oil and gas industry, the issues that could prevent the opportunities from being fully realised, and the options for addressing those issues. An update of Industry Strategy developments, including as they relate to greenhouse issues, was provided in the Second Implementation Report, *State of the Industry 2009*<sup>5</sup>, released on 1 June 2009.

With this in mind, APPEA's submission has been generally organised to address specific sections of the Bills and associated Explanatory Memorandum. However, the submission does not directly address every aspect of the Bills. Rather, it focuses on those areas that are particularly important for Australia's upstream oil and gas industry and on the changes to the Scheme announced by the Prime Minister, the Hon Kevin Rudd MP, on 4 May 2009<sup>6</sup>.

Very importantly, APPEA's comments are also made within the context of the pre-election commitments<sup>7</sup> provided by the Government, that included to:

- *ensure that Australia's international competitiveness is not compromised by Australia's response to climate change;*
- *ensure that Australian operations of emission intensive trade exposed firms are not disadvantaged by emissions trading; and*

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<sup>3</sup> The *Greenhouse Response Strategy* can also be downloaded from the APPEA website, at [www.appea.com.au/content/pdfs\\_docs\\_xls/PolicyIndustryIssues/APPEAGreenhouseResponseStrategyNov03.pdf](http://www.appea.com.au/content/pdfs_docs_xls/PolicyIndustryIssues/APPEAGreenhouseResponseStrategyNov03.pdf).

<sup>4</sup> See [www.appea.com.au/index.php?option=com\\_content&task=blogcategory&id=79&Itemid=81](http://www.appea.com.au/index.php?option=com_content&task=blogcategory&id=79&Itemid=81) for further information about the Industry Strategy process and [www.appea.com.au/content/pdfs\\_docs\\_xls/IndustryStrategy/Strategic%20Leaders%20Report.pdf](http://www.appea.com.au/content/pdfs_docs_xls/IndustryStrategy/Strategic%20Leaders%20Report.pdf) for a copy of the *Platform for Prosperity* report.

<sup>5</sup> A copy of the *State of the Industry 2009* Report can be found at [www.appea.com.au/content/pdfs\\_docs\\_xls/appea\\_slr\\_ir2\\_public\\_final.pdf](http://www.appea.com.au/content/pdfs_docs_xls/appea_slr_ir2_public_final.pdf).

<sup>6</sup> See [www.pm.gov.au/media/Release/2009/media\\_release\\_0969.cfm](http://www.pm.gov.au/media/Release/2009/media_release_0969.cfm) for further information.

<sup>7</sup> Australian Labor Party (2007), *Labor's Plan for a Stronger Resources Sector*, 22 November (available at [www.alp.org.au/download/now/071122\\_labors\\_plan\\_for\\_a\\_stronger\\_resources\\_sector222.pdf](http://www.alp.org.au/download/now/071122_labors_plan_for_a_stronger_resources_sector222.pdf)).



- *consult with industry about the potential impact of emissions trading on their operations to ensure they are not disadvantaged.*

The vital nature of these commitments will be further considered in Section 2.1.

## 2. COMMENTS ON THE BILLS

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### 2.1 Treatment of trade-exposed industries (Part 8 of the draft *Carbon Pollution Reduction Scheme Bill 2009*): the role of LNG as a cleaner global contributor

APPEA notes Part 8 of the Bill sets out, in eight pages, the proposed treatment of trade exposed industries. Almost all of the key details of the treatment are proposed to be set out in regulations and not in the Act itself.

APPEA again recommends the treatment of trade exposed industries be included in the Act itself and not relegated to regulations.

#### 2.1.1 General comments

As has been considered and accepted by every major credible analysis of an emissions trading scheme undertaken in Australia and internationally, if policies and measures such as emissions trading schemes are implemented in some countries and not in others, there are distortions that can occur as a result of the escalation in production costs in the countries that have implemented greenhouse policies relative to those that have not.

APPEA has long recommended 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 emissions-intensive trade-exposed 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, the industry's key objective in considering this issue is to ensure that the Australian liquefied natural gas (LNG) industry does not bear an additional cost impact for as long as the Australian LNG industry's competitors and customers are not subject to a similar impost.

The importance of this issue cannot be underestimated: a domestic emissions trading scheme would 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.

### 2.1.2 Treatment of the LNG industry under Part 8 of the Carbon Pollution Reduction Scheme Bill 2009

APPEA acknowledges that the Government has taken steps to clarify the impact of the proposed emissions trading scheme on Australia's LNG industry. This means that provided it meets the criteria set out in the Explanatory Memorandum to the *Carbon Pollution Reduction Scheme Bill 2009* at paragraph 4.12 (and APPEA continues to work with the Department of Climate Change in the formal emissions intensity and trade exposure assessment process), LNG may qualify for an administrative allocation of permits to cover up to nominally 60 per cent of emissions in the first year of the scheme's operation (nominally 66 per cent for a short period taking into account the proposed Global Recession Buffer announced by the Prime Minister on 4 May 2009 and outlined at paragraph 4.13 of the Explanatory Memorandum).

It remains the case, however, that the industry will be subject to a significant cost burden that is not borne by its LNG competitors<sup>8</sup> or customers. Reducing the international competitiveness of Australia's LNG industry will lead to growth prospects being constrained and a likely commensurate increase in global emissions as developing countries continue to expand their use of more carbon intensive fuels.

In this context, arguments raised by some that the industry can "afford to pay" are economically naïve and fail to recognise the range of factors which influence investment decisions in the Australian LNG industry. Discussions around a perceived capacity to pay convey an unfounded confidence that companies with multiple global investment choices will invest in new Australian LNG projects. Carbon costs of the kind implied by the Scheme would represent a substantial addition to operating costs and a substantial reduction in profit margin.

Most importantly, with competitors not facing comparable costs, the decision about which project proceeds next and whether a particular project proceeds at all, may be affected. The omitted or deferred investment funds would be spent elsewhere in the world, and no global emissions benefit would have been achieved.

Good policy design is not about profitability. While the oil and gas industry has in the recent past experienced profitability this does not equate to or should be considered a reason for influencing the design of the Scheme. Proposals that treat firms or industries differently based on profitability undermine the integrity of the overall scheme design. Designing an effective and efficient scheme to meet the (appropriately amended, as considered further below) Objects of the Bill is not reliant on and should not be reflective of industry profitability. Design of the Scheme should be focused on the long-term viability of industries that would expand if a global carbon price signal scheme were in place, not on the short-term profits over the course of a business cycle.

APPEA noted in its submission to the Carbon Pollution Reduction Scheme Green Paper<sup>9</sup>, to the Senate Select Committee on Fuel and Energy<sup>10</sup>, to the Senate Select Committee on Climate

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<sup>8</sup> Australia's LNG industry faces fierce global competition. Australia's major LNG competitors include Qatar, Algeria, Nigeria, Trinidad & Tobago, Egypt, Brunei, Indonesia, Malaysia, Oman and the United Arab Emirates.

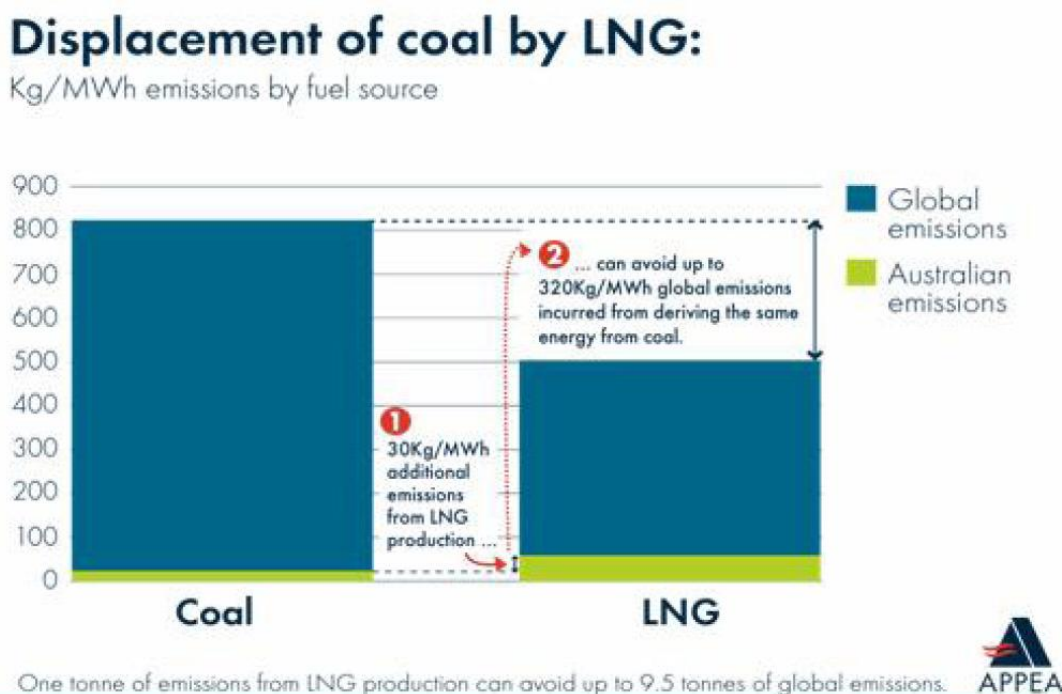
<sup>9</sup> APPEA's submission to the Carbon Pollution Reduction Scheme Green Paper can be found at [www.climatechange.gov.au/greenpaper/consultation/pubs/0834-appea.pdf](http://www.climatechange.gov.au/greenpaper/consultation/pubs/0834-appea.pdf).

<sup>10</sup> APPEA's submissions to the Senate Select Committee on Fuel and Energy can be found at [www.aph.gov.au/Senate/committee/fuelenergy\\_ctte/submissions/Sub0018.pdf](http://www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/Sub0018.pdf), [www.aph.gov.au/Senate/committee/fuelenergy\\_ctte/submissions/sub0018a.pdf](http://www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/sub0018a.pdf) and [www.aph.gov.au/Senate/committee/fuelenergy\\_ctte/submissions/sub0018b.pdf](http://www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/sub0018b.pdf).

Policy<sup>11</sup>, to the Government on the Exposure Drafts of the Bills<sup>12</sup> and in its March 2009 submission to the Committee that it would be unfortunate if, by unnecessarily constraining Australia's LNG industry, the design of the emissions trading scheme were inadvertently to undermine the Scheme's ultimate objective of helping the world to reduce greenhouse gas emissions.

LNG has been characterised as an 'anomaly' within the emissions trading scheme design. Although producing LNG is emissions intensive and adds to greenhouse gas emissions in Australia, natural gas makes a substantial net contribution to reducing global greenhouse gas emissions. As the world inevitably shifts to a preference for cleaner burning fuels, the substantial strategic value of Australia's natural gas assets can only increase.

The following diagram illustrates the point. Analysis undertaken by CSIRO<sup>13</sup> in 1996, WorleyParsons<sup>14</sup> in 2008 and PACE<sup>15</sup> in 2009 shows that although LNG production requires energy and is itself emissions-intensive, for every tonne of greenhouse gas emitted in the production of Australian LNG, between 4 and 9.5 tonnes of greenhouse gas emissions are avoided in customer countries if LNG is used to displace higher emission fuels in electricity generation.



Source: CSIRO, WorleyParsons.

<sup>11</sup> APPEA's submission to the Senate Select Committee on Climate Policy can be found at [www.aph.gov.au/Senate/committee/climate\\_ctte/submissions/sub395.pdf](http://www.aph.gov.au/Senate/committee/climate_ctte/submissions/sub395.pdf), [www.aph.gov.au/Senate/committee/climate\\_ctte/submissions/sub395a.pdf](http://www.aph.gov.au/Senate/committee/climate_ctte/submissions/sub395a.pdf) and [www.aph.gov.au/Senate/committee/climate\\_ctte/submissions/sub395b.pdf](http://www.aph.gov.au/Senate/committee/climate_ctte/submissions/sub395b.pdf).

<sup>12</sup> The Department of Climate Change has not made these submissions available at their home page, so a copy of the APPEA submission can be found at **Attachment 2**.

<sup>13</sup> CSIRO (1996), *Lifecycle emissions and energy analysis of LNG, oil and coal*, December.

<sup>14</sup> WorleyParsons (2008), *Greenhouse Gas Emissions Study of Australian LNG*, July.

<sup>15</sup> Center for Liquefied Natural Gas (2009), *Life Cycle Assessment of GHG Emissions from LNG and Coal Fired Generation Scenarios: Assumptions and Results*, PACE, Fairfax, Virginia, US, February.



Realising the full economic and environmental potential of Australia's natural gas requires a commitment from both Government and industry to identifying and removing impediments to its development. LNG is a proven industry with significant and imminent growth prospects in Australia. The impact of this industry's growth on regional development and employment, as well as Government earnings is set to be substantial.

APPEA agrees with Professor Ross Garnaut<sup>16</sup> who in his Final Report on pages 344-345 stated that a fundamental principle in designing a domestic emissions trading scheme 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, noting

*The rationale for payments to trade exposed, emissions-intensive industries is different and sound. It is to avoid the economic and environmental costs of having firms in these industries contracting more than, and failing to expand as much as, they would in a world in which all countries were applying carbon constraints involving similar costs to ours.*

The Final Report goes on to say:

*A constructive and efficient solution must focus on policy design that assists our domestic industries to address the failure of our global competitors to act on limiting their carbon emissions.*

APPEA was therefore disappointed that an important rationale for permit allocation to trade exposed industries outlined in the Green Paper was subsequently removed in the White Paper and is not reflected in the objects of this Part of the Bill at Section 165. The third rationale for recognising trade exposed industries in the Green paper was *"to support production and investment decisions that would be consistent with a global carbon constraint"*. This has been removed as a principle and transformed into a vague statement of expectation that this may be a partial consequence of trade exposed industry treatment. It is not reflected in Section 165 of the Bill at all.

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. Yet, the domestic scheme, as proposed, would see the industry's growth, growth that is both economically efficient and environmentally effective, constrained<sup>17</sup>.

The LNG industry can think of no explanation for a design that results in a cost burden for an Australian industry that is poised for growth precisely because of the world's desire for less greenhouse gas emitting sources of energy. Inadvertently, it could send a message that Australia is unconcerned that this growth, and all the environmental, economic and social benefits associated with it, will occur, instead, in those LNG producing countries with which we compete.

There is a global environmental benefit to encouraging the expansion of the natural gas industry, including cleaner global contributors like Australian LNG. Under a global carbon constraint,

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<sup>16</sup> Garnaut, Professor Ross (2008), *The Garnaut Climate Change Review: Final Report*, 30 September, pages 344-345 (available at [www.garnautreview.org.au/index.htm](http://www.garnautreview.org.au/index.htm)).

<sup>17</sup> Arguments have been made that a lack of investment in LNG would be made up by investments in other parts of the economy and that a trade exposed industry treatment for LNG would "crowd out" this other investment. Such a view is misinformed. As noted above, it is economically efficient and environmentally effective for LNG to grow under a global carbon constraint. The lack of appropriate treatment from LNG under the Bill will result in less efficient investment "crowding out" LNG investment, to the detriment of both the Australian economy and the global environment.

natural gas and the LNG industry could be expected to expand and Australia could play a key role in that global growth. The Bill however, only partly recognises the potential of domestic gas and fails to recognise cleaner global contributors, particularly LNG, when contemplating national and international reduction targets.

In many cases, project proponents will receive substantially less than a 66 per cent permit allocation as a consequence of directly linking permit allocation to production. This linkage, whilst potentially appropriate in considering the liquefaction plant itself, penalises developments that are based on gas fields with higher reservoir carbon dioxide content than existing projects, even though differences in reservoir emissions are small in relation to the global emission reductions that the greater utilisation of natural gas will deliver and the project proponents have no control over the carbon dioxide content (such content being a function of the geology of the reservoir itself).

The case for the industry not to be exposed to any cost associated with a domestic emissions trading scheme while ever our competitors and customers (with cheaper, higher emitting energy choices available) are not subject to similar imposts is compelling.

### 2.1.3 Options to provide an appropriate treatment of emissions-intensive trade-exposed industries

Clearly, amendments to Part 8 of the *Carbon Pollution Reduction Scheme Bill 2009* continue to be required.

APPEA recommends the *Carbon Pollution Reduction Scheme Bill 2009* be amended to ensure the LNG industry, both existing and future activities, does not face any cost associated with a domestic emissions trading scheme while ever our competitors and customers (with cheaper, higher emitting energy choices available) are not subject to similar imposts.

- This could be achieved by ensuring an administrative allocation of permits of 100 per cent of direct ('scope 1') emissions and 100 per cent of permits needed to fully offset costs passed-through by non-trade exposed industry (typically in electricity prices, gas prices and feedstock prices).
- It would also require removal of the allocation 'decay' of 1.3 per cent per annum (the so-called 'carbon productivity contribution').
- Permit allocation should be made to existing operations based on fixed relationships between output and direct emissions and non-trade exposed cost pass-through measured in a typical recent year or average of years.

As was noted by AIGN in its March 2009 submission to the Committee, if permit allocation was based on trade exposure, then the complicated design elements involving 'emission intensity' tests and narrow and artificial definitions of 'activity' are not required.

In addition, analysis prepared for APPEA by Access Economics<sup>18</sup>, shows that providing a 100 per cent permit allocation will result in the continued growth of the LNG industry in

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<sup>18</sup> Access Economics (2009), *Indicative costs and benefits of a LNG emissions costs offset*, January.

Australia and a reduction in the growth in global emissions. It shows that, in all cases analysed<sup>19</sup>, the economic growth benefits of an expanding LNG industry outweigh any costs associated with the permit allocation.

In addition, providing permits to the LNG industry does not 'shift the burden' onto other sectors of the Australian economy. The LNG industry exports 100 per cent of its relevant production. This makes LNG unique in an economic sense, in that, all production takes place domestically but is consumed in foreign markets. As such, the LNG industry does not fit with standard economic analysis that has been applied to this issue in the public debate.

There are two parts to 'burden shifting':

- first, when the carbon the price of the good is passed onto consumers and downstream industries (without compensation); and
- secondly, the incentives of the LNG sector to undertake abatement measures.

On the first point, the North West Shelf and Darwin LNG facilities and the other export facilities under consideration have no domestic consumers, either industry or households. If you have no domestic consumers higher costs are not passed to domestic consumers. No other sector will be asked to carry a heavier burden in terms of paying a higher price should permits be administratively allocated to LNG.

On the second point, whether or not permits are administratively allocated or through auctioning the LNG industry has the same incentive to reduce emissions. As will be considered further below, a permit that is administratively allocated has an opportunity cost –this means that the firm will make a decision on whether to acquit the permit or undertake abatement and sell the permit in the market. As the Commentary to the draft Bill noted at paragraph 4.6 "... *the opportunity cost of each Australian emissions unit to a firm is the same ...*"<sup>20</sup> regardless of whether they are allocated or purchased at auction or on the secondary market –they are not 'free'.

A number of additional amendments to the Bill are also required:

- Section 165(e) and (f) should be deleted. Section 165(e) is focussed on large emitting countries, when the real issue for trade exposed industries is the action of competitors –this is captured in Section 165(d);
- a new object should be added to Section 165 to reflect that a fundamental principle in designing a domestic emissions trading scheme 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; and

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<sup>19</sup> The scenarios modelled were those used in the Treasury modelling report, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation*, included the four scenarios modelled by the Treasury (known as "CPRS -5", "CPRS -15", "Garnaut -10" and "Garnaut -25").

<sup>20</sup> APPEA notes that this commentary has been omitted from paragraph 4.6 of the Explanatory Memorandum.

- references to 'free' permits should be removed and replaced by 'administratively allocated'. As was noted above, the opportunity cost of each Australian emissions unit to a firm is the same regardless of whether they are allocated or purchased at auction or on the secondary market – they are not 'free'.

## 2.2 Objects of the draft *Carbon Pollution Reduction Scheme Bill 2009* (Section 3)

APPEA notes that the Objects of the *Carbon Pollution Reduction Scheme Bill 2009*, as set out in Section 3, only partly reflect the appropriate policy objectives of the Bill and its role in greenhouse policy development.

APPEA therefore recommends the objects of the *Carbon Pollution Reduction Scheme Bill 2009* be expanded to include that it should:

- impose a price on emissions;
- offset competitive disadvantage for emissions-intensive trade-exposed industries; and
- replace existing measures no longer required in the presence of a price on greenhouse gas emissions.

## 2.3 National scheme cap and National scheme gateway (Section 14(5)(b), (c) and Section 15 of the draft *Carbon Pollution Reduction Scheme Bill 2009*)

At Section 14(5)(b) and Section 15 the matters that the Minister 'may'<sup>21</sup> take into account in setting the five year caps and ten year gateways include the report (if any) of the Expert Review Committee. APPEA notes the Expert Review Committee does not allow appointment of a person that is a director, officer or employee of a liable entity in the financial year in which the appointment is made.

APPEA recommends that rather than having an ad hoc Expert Review Committee established, the Productivity Commission be appointed to undertake these Reviews.

In addition, APPEA notes the matters that the Minister 'may' take into account in setting the five year caps and ten year gateways is limited under Section 14(5)(c) and 15. Specifically, these Sections include no definitions of major/advanced economies, no definition of voluntary action and no methodology for increasing coverage.

APPEA recommends that these matters be added to the list of matters that the Minister 'may' take into account in setting the five year caps and ten year gateways is limited under Section 14(5)(c) and 15.

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<sup>21</sup> In contrast to the draft of the Bill, where it was proposed the Minister 'must' take into account such a report.

## **2.4 Amendments to Corporations Act 2001 and Australian Securities and Investments Commission Act 2001 (Schedule 1, Part 1, item 4-6 and Schedule 1, Part 1, item 1 of the Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009)**

The amendments contained in Schedule 1, Part 1, item 4-6 and Schedule 1, Part 1, item 1 of the *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009* will mean Australian emissions units and eligible international emissions units are to be financial products for the purposes of the Chapter 7 of the *Corporations Act 2001* and Division 2, Part 2 of the *Australian Securities and Investments Commission Act 2001*.

APPEA notes the Explanatory Memorandum to the Bill at page 80 states that:

*These amendments will provide a strong regulatory regime to reduce the risk of market manipulation and misconduct. Appropriate adjustments to the regime to fit the characteristics of units and avoid unnecessary compliance costs will be made. Further consultation is being undertaken on the adjustments that may be necessary, particularly through the amendment of regulations.*

The absence of the final detail about the ‘adjustments’ make it very difficult to comment on the appropriateness of this parts of the Bill. APPEA notes that the Department of Climate Change released an Issues Paper<sup>22</sup>, *Eligible Emissions Units as Financial Products*, in April 2009 for comment by 6 May 2009 (five business days before the Bills were introduced into the Parliament), but that none of the issues considered in that paper are reflected in the Bills. APPEA notes that if these units are as proposed categorised as ‘financial products’, many liable entities will need to obtain Australian Financial Services Licences (AFSL) in order to participate in the relevant markets. Obtaining an AFSL can be a significant process taking upwards of six months with major ongoing compliance issues.

APPEA notes the Parliament is being asked to pass this Bill without the full detail of its implications for liable entities being understood and recommends the Department complete its consultations as a matter of urgency with the overarching aim of this part of the Bill being to minimise initial and ongoing compliance costs for liable entities.

## **2.5 Purchase and Acquittal of Compliance Permits –Unincorporated Joint Ventures (Section 11B and 11C of the Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009)**

Upstream oil and gas industry projects in Australia are generally undertaken by way of 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 does not necessarily lead to the creation of a legal entity. Under the JOA, the parties (or participants) appoint an operator to manage and undertake joint venture activities on behalf of the parties to the JOA. The operator provides a work program and budget to the participants, that is approved by a resolution of all participants, and subsequently applies for funding of the work program through separate authority (for expenditure) from all participants.

All assets of the joint venture are owned jointly by the participants, however liabilities are several and not joint or collective. This requires each participant to be responsible only for its individual

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<sup>22</sup> This Issues Paper is available at [www.climatechange.gov.au/emissionstrading/auction/pubs/FinancialProductPaper.pdf](http://www.climatechange.gov.au/emissionstrading/auction/pubs/FinancialProductPaper.pdf).



obligations. Participants have an entitlement under the JOA to take in kind their participating share of production. The model is common world-wide.

The *National Greenhouse and Energy Reporting Act 2007* indicates the corporation with “operational control”, or a party nominated by the joint venture, of a facility has liability to report emissions in respect of that facility. The controlling corporation will be in the best position to discharge the reporting obligations under the *National Greenhouse and Energy Reporting Act 2007*. Reporting and measuring aside, however, in the case of a UJV, the commercial, legal and financial obligations typically belong to each joint venture participant.

In the upstream oil and gas industry, the operator of the project generally executes the activities that lead to a resulting product, but they do not have ownership of the molecules, assets or resultant product (except to the extent of their own participating interest). Therefore, the controlling corporation (or operator) for reporting purposes should not be the person liable for meeting liabilities for the acquittal of emissions of a UJV.

It is important that 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 interest in the joint venture. Similarly, in the context of administratively allocated permits (such as those provided to trade exposed industries), they should be allocated to individual participants within UJVs, again on the basis of their interest in the joint venture. It is important to note that the ability to issue a Liability Transfer Certificate (considered in Division 6 of the *Carbon Pollution Reduction Scheme Bill 2009*) in respect of a facility does not resolve this issue.

The “push down” of liabilities to each underlying joint venture participant is also essential for the effective operation and administration of Australia’s fiscal rules. 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 recommends that for activities undertaken within unincorporated joint ventures, specific reference be included within the legislation to ensure that the liability for acquittal rests with the individual joint venture participants in proportion with their interest in the joint venture. Participants with projects/activities being undertaken within unincorporated joint ventures be provided with flexibility in meeting their obligations to ensure that any final measures are complementary to the legal and commercial framework within which these structures operate.

## **2.6 Taxation amendments (Schedule 2 of the *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009*)**

APPEA notes that Schedule 2 of the *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009* proposes a number of amendments to the *Income Tax Assessment Act* to give legislative effect to certain fiscal treatments for activities associated with the Scheme. APPEA believes tax treatments for costs and revenues need to be assessed against a number of key principles:

- expenditures or costs on abatement activities within a framework agreed by the government should be fully deductible;

- the taxation treatment of expenditures associated with permit acquisitions should be no different from the treatment of other eligible expenditures incurred by a person in the course of conducting business activities; and
- taxation treatments should not influence a party's decision in choosing between alternative methods to abate or acquit a greenhouse gas emissions liability. That is, a decision to pursue an abatement option should not be distorted through the application of the taxation treatment of that option.

APPEA recommends that the Committee rigorously assesses the proposed taxation outcomes against the above criteria to ensure that the fiscal framework does not act to distort decisions associated with alternative abatement actions undertaken by parties operating under the Scheme.

### **2.7 Accounting for registered emissions units you hold at the start of or end of the income year (permits issued under Part 10 of the draft *Carbon Pollution Reduction Scheme Act 2009*)**

APPEA notes that for the purpose of Subsection 420-55 (1), permits issued under Part 10 of the *Carbon Pollution Reduction Scheme Act 2009* are valued at cost. Cost is defined in Subsection 420-60(1) as the market value immediately after a taxpayer begins to hold the unit. The effect of this is that an amount will be included in a taxpayer's assessable income under Subsection 420-45(2) equal to the market value of such permits at the acquisition time if the permits were still held at the end of the year. This has the potential for adverse cash flow consequences for an entity as they will effectively be taxed on income they have not earned.

This issue has been recognised in relation to units issued to trade exposed industries with the insertion of a "no disadvantage rule" under Subsection 420-57 that operates to ensure that the value of such permits on hand at the end of the year is nil. In APPEA's view, there is no policy reason to differentiate permits issued as a result of carbon sequestration by reforestation from permits issued to trade exposed industries. To do so could affect an entity's commercial choice as to how they would choose to satisfy their obligations under the Scheme with generation of permits by carbon sequestration by reforestation coming with a cash flow cost.

APPEA recommends the Bill be amended to move wording at Subsection 420-57(1)(a) to 420-57(1)(a)(i) and replace "and" with "or" at the end of the sentence. APPEA further recommends that a Subsection 420-57(1)(a)(ii) be inserted as follows "it was issued to you in accordance with Part 10 (reforestation) of the *Carbon Pollution Reduction Scheme Act 2009*".

### **2.8 Australian boundaries (Section 11A, Section 22A, Section 22B and Section 22C of the *Carbon Pollution Reduction Scheme Act 2009*)**

APPEA notes that Section 11A of the *Carbon Pollution Reduction Scheme Act 2009* extends Australia's domestic emissions trading scheme to the Joint Petroleum Development Area (JPDA) and Sections 22A, 22B and 22C adjust an eligible entity's unadjusted 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 *Carbon Pollution Reduction Scheme Act 2009*, at paragraph 1.282 and 1.283, says

*The Act 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 11A]. The regulations will specify the percentage of the emissions from facilities in the Joint Petroleum Development Area and the Greater Sunrise Field which are subject to the Scheme. These regulations will specify percentages consistent with Australia's responsibilities under international law [Part 3, Division 2, clauses 22A — 22C].*

*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.*

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. Hence APPEA members 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.

With the Bill extending the operation of the Scheme to JPDA, the Australian Government should urgently investigate the negative effect this will have on the ability of Timor-Leste, a developing country<sup>23</sup>, to attract investment to the JPDA as compared to other developing countries that do not have plans to impose a carbon cost at this time. The ramifications for Timor-Leste' development of imposing a carbon cost well ahead of other developing countries should be carefully considered and include examining the potential negative development impacts for the Timor-Leste' people.

To gain a comprehensive understanding of the impacts from the proposed application of the Scheme to an international treaty area such as the JPDA, APPEA recommends the Australian Government consult with the Timor-Leste Government and a wide range of national and international stakeholders (oil and gas companies, international organisations, Timor-Leste civil society and others). APPEA recommends a comprehensive stakeholder engagement plan and timeline be developed to underpin these consultations.

APPEA further recommends this consultation and the associated consultation necessary to develop the regulations that will specify percentages for emissions from facilities in the Joint Petroleum Development Area and the Greater Sunrise Field that are subject to the Scheme be undertaken as a matter of urgency.

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<sup>23</sup> As an example, Timor-Leste is ranked 158<sup>th</sup> out of a total of 179 countries (with the countries ranked below Timor-Leste being the least developed African nations) and the lowest in the Asia-Oceania region on the Human Development Index (HDI), used by the United Nations Development Program as a comparative measure of life expectancy, literacy, education and standards of living for countries worldwide. The HDI is a standard means of measuring well-being, especially child welfare. It is used to distinguish whether the country is a developed, a developing or an under-developed country, and also to measure the impact of economic policies on quality of life. As a point of comparison, Australia is ranked 1<sup>st</sup> in the Asia-Oceania region and 4<sup>th</sup> in the world, behind Iceland, Norway and Canada. See [hdr.undp.org/en](http://hdr.undp.org/en) for further information.

### 3. OTHER ISSUES

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As noted above, a number of issues are not still not included in the legislation introduced into Parliament. This failure continues to limit 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 lack of any 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 to determine the allocation of the national commitment among the covered (by the Scheme) and uncovered sectors;
- auction design. The Explanatory Memorandum to the *Carbon Pollution Reduction Scheme Bill 2009*, notes a paragraph 3.18

*The detailed policies, procedures and rules for the conduct of auctions will be included in a legislative instrument to be made by the Authority [Part 4, Division 2, clause 103].*

The Department had indicated a discussion paper would be issued at end of March 2009, but has delayed consultation until the release of a draft legislative instrument in “late” 2009. This means it is proposed the detailed policies, procedures and rules for the conduct of auctions, the principal method for release of permits to the market, will not be known until well after the legislation is planned to be passed;

- international linking provisions;
- export control provisions for the future sale and transfer of Australian emissions units to foreign registries. The Commentary to the draft *Carbon Pollution Reduction Scheme Bill 2009*, at paragraph 2.29, stated

*Provisions that allow for the future sale and transfer of Australian emissions units to foreign registries (export) will be included in the final bill.*

The Explanatory Memorandum to the *Carbon Pollution Reduction Scheme Bill 2009*, however, states at paragraph 2.44 in direct contrast to this position

*Provisions that allow for the future sale and transfer of Australian emissions units to foreign registries (export) are not included in the bill.*

APPEA recommends all of these issues be the subject of consultation with stakeholders before the Bills are passed by the Parliament. Once they are available, the Committee may wish to consider a supplementary inquiry into the additional provisions to give effect to these issues.



AUSTRALIAN PETROLEUM PRODUCTION & EXPLORATION  
ASSOCIATION LIMITED

# **GREENHOUSE RESPONSE STRATEGY**

*COMMITMENTS OF THE UPSTREAM OIL AND GAS  
INDUSTRY*

*PUBLIC POLICY RESPONSE: A GOVERNMENT/INDUSTRY  
PARTNERSHIP*



# **APPEA GREENHOUSE RESPONSE STRATEGY**

APPEA, and its members, are committed to working towards a profitable, safe, environmentally responsible and socially responsible oil and gas exploration, development and production industry. As a part of this, APPEA wants to work with governments to achieve credible industry actions and governmental greenhouse policies that address greenhouse concerns in an economically and commercially viable way.

The Council of Australian Governments (COAG) recognises in its energy policy of 8 June 2001 that Australia will be dependent on fossil fuels to meet its energy needs for the foreseeable future.

It should be noted that gas as a fuel, particularly in power generation, can create improved emissions outcomes in Australia and that LNG exports can contribute to an improved global outcome. In that context, APPEA supports the removal of regulatory impediments to the increased use of gas.

In addition to commitments by the upstream oil and gas industry, APPEA is seeking to develop a public policy response that meets the needs of State and Commonwealth governments and fits within the following three components:

- immediate actions;
- medium term responses; and
- longer term policy principles.

## ***COMMITMENTS OF THE UPSTREAM OIL AND GAS INDUSTRY***

APPEA members:

- will continue to create and take opportunities for economic emission abatement and sequestration;
- are committed to continuous improvement in relation to both emission abatement and sequestration as new technology becomes commercial;
- support the Greenhouse Challenge Program to promote further emission abatement;
- will examine all commercially practicable options for improved energy efficiency;
- continue to work with customers to promote the efficient use of products; and
- are financing and participating in research and development into the geological disposal of CO<sub>2</sub> and will consider other opportunities for R&D into sequestration and emission abatement.

APPEA is ready to input into modeling work on greenhouse projections and to participate in dialogue as government develops policy to ensure that APPEA is part of the debate process and can help influence a least cost outcome for the industry and its major customers.

APPEA will take opportunities to brief all stakeholders, including environmental NGOs, on APPEA's position on greenhouse abatement.

## ***PUBLIC POLICY RESPONSE: A GOVERNMENT/INDUSTRY PARTNERSHIP***

### ***Immediate Actions***

APPEA believes all governments in Australia should adopt a nationally coordinated approach to greenhouse policies. State governments should not introduce policies and mechanisms inconsistent with a national approach. APPEA welcomes the commitment by State and Territory government leaders on 29 August 2003 to working with the Federal Government to achieve a national approach to this important issue.

Governments need to continue to recognise that greenhouse policies must allow Australian industry to maintain its international competitiveness. APPEA will work with government to develop ways to maintain international competitiveness in keeping with the Commonwealth Government's commitments to industry, including the LNG Action Agenda. In this regard, the Government should

take into consideration international developments and their implications for Australia in its policy formulation.

The impact of greenhouse policies on the industry's customers needs to be recognised as a critical test of the appropriateness of greenhouse policies. In addition, the commitment by the Commonwealth Government on No Disadvantage for Early Movers is essential in maintaining Australia's international competitiveness and keeping Australia attractive to investment.

### ***Medium Term Responses***

In the policy framework formulated by the Australian government, APPEA supports and advocates a four-point program for joint government/industry action to deliver a national approach to greenhouse gas emissions management which extends into the next decade and beyond. Technology alone will not provide the solution to long term reductions in emissions levels. APPEA will work with governments on other initiatives which reduce emissions cost effectively and maintain Australia's export competitiveness.

- The Association would argue that all initiatives proposed for inclusion in such a program must be exposed to a robust, independent assessment of their costs, community impacts and benefits before they are pursued.

APPEA supports the following 'foundation set' of four policy thrusts to facilitate the current and forward strategies for greenhouse gas management in Australia. The four key strategies are:

- 1) support for continued pursuit by Australia of an *international negotiation process* that meets the needs of Australia and also sets a path forward for comprehensive global action;
- 2) implementation of an *enhanced greenhouse impacts modeling program* directed at giving better information on climate impacts (variable, intensity, variability, timing, location);
- 3) implementation of a *mandatory national emissions reporting and verification system*;
- 4) development by Australia of a flexible portfolio of *emission abatement actions* incorporating:
  - a. the retention and enhancement of some existing programs;
  - b. a national end use efficiency program;
  - c. consideration of the development of appropriate administrative mechanisms or processes directed at giving industry greater certainty about greenhouse outcomes; and
  - d. a strategy for the development and adoption of commercially viable low emission technologies.

Effectively:

- strategy 1 sets the long term policy context within which a flexible national approach will need to evolve. This would be progressively refined over time, e.g. as the role of the Kyoto Protocol became clearer and a better understanding is gained on (but to clarify this context we need to know whether Russia will ratify Kyoto and know how the post 2012 treaty negotiations, which commence in 2005, might evolve);
- strategies 2 and 3 will deliver an adequate factual data base to allow company and national responses to be properly formulated; and
- strategy 4 is an actions package.

An alternative way of viewing the strategies 2-4 is that:

- strategy 2 is about adaptation; and
- strategy 3 and 4 are about emission abatement.

### **Strategy 1: The International Commitment**

Climate change is a global issue and requires comprehensive global agreement if it is to be effectively addressed. Development of effective international arrangements (whether multilateral or of another kind) must be a central part of any national policy approach. Where appropriate, Australia should continue to pursue bi-lateral and pluri-lateral agreements, particularly in relation to RD&D. APPEA (and/or its member companies) will participate in activities under international agreements, including:

- geo-sequestration work under the Bilateral Agreement with the USA;

- policy and technical work as part of the Carbon Sequestration Leadership Forum (for example a substantial body of work will be done over the next six to twelve months on global regulation of geo-sequestration);
- the promotion of natural gas as apart of the APEC energy work (helping us to develop LNG market opportunities); and
- promotion of zero emission technologies by international agencies such as the International Energy Agency and the World Bank.

The development of effective international arrangements should be aimed at achieving the least-cost outcome for Australia and the global community. Above all, it is the reduction in net global emissions of greenhouse gases that is important and international agreements should reflect this.

#### Strategy 2: The Adaptation Commitment - Enhanced Greenhouse Impacts Modeling Program

Once adequate location specific data on potential impacts of climate variability are available, APPEA member companies will, as appropriate, review (and if necessary adapt) their risk management strategies (encompassing engineering design, safety and environmental assessments) to reflect new learnings on the likely impacts of climate variability). Government will also need to complement industry action by developing risk management strategies in areas such as health care, water supply, emergency services and suitable developments in coastal areas and on flood plains. This sort of action planning should give the community greater confidence about how the greenhouse issue is being addressed.

#### Strategy 3: Mandatory Emissions Reporting

A mandatory national emissions reporting and verification system should be developed. The methodologies and tools for this should be consistent with the Greenhouse Challenge Program objectives and internationally recognised emission estimation methodologies. This would be applicable to all organisations/facilities emitting over an agreed threshold. A lower threshold could potentially be phased in over time.

Without an adequate emissions database/emissions inventory, companies cannot calculate the likely impact of particular policies on their bottom line and government can't adequately develop well targeted and effective policies. Both government and industry get better information on the cost and difficulties of assembling credible data that will meet commercial and policy integrity requirements.

#### Strategy 4: The Development of a National Portfolio of Emission Abatement Actions

(a): The Australian Government must act to ensure efficient continuation of a number of existing programs to encourage industry and government instrumentalities to continue to take all commercially practicable measures to abate emissions. The continuation of these programs is essential, particularly in meeting the 108 percent objective, but also in laying the foundation for two of the other vital elements of the Abatement Package proposed by APPEA, namely administrative mechanisms or processes and a comprehensive national end-use efficiency program designed to achieve a cost-effective, world-class approach to efficient energy use.

The key programs/policy areas for APPEA include:

- the Greenhouse Challenge Program - APPEA is committed to continuing to be an active participant in this program;
- removal of regulatory impediments to the greater use of gas in the national energy market – including via cogeneration and distributed energy uses; and
- investment incentives, such as an enhanced version of the Greenhouse Gas Abatement Program (GGAP).

It must also be recognised that there must be an equitable share of the abatement across the economy and not merely targeted at any particular industry. As such, continuation of programs targeted at end use efficiency and land use measures, including cessation of land clearance, constraint of urban sprawl and re-vegetation programs, are an integral component of the portfolio of abatement actions.

- (b): An end-use efficiency program would focus on efficiency on both the demand and supply side. In particular, it would require a strong focus on use at the household and small business level. Further, it would need to look at appropriate cogeneration and distributed energy technologies. In many instances, outcomes may best be achieved through investment incentives. While there is a requirement for new programs to address end-use efficiency, there are a number of programs that are already in operation, but these would need to be expanded. These include:
- enhanced building codes; and
  - an energy efficiency labeling programs.
- (c): Taking into account relevant global experience, consider a range of appropriate and flexible administrative mechanisms or processes to encourage additional cost effective reductions in greenhouse gas emissions. Such programs should be consistent with commitments given to industry in the LNG Action Agenda. They should give both industry and government greater certainty about greenhouse outcomes and allow governments to commit to 'no disadvantage' for early movers in greenhouse emission abatement. The mechanisms or processes should be designed to encourage industry to employ new approaches, both technical and commercial, which result in reduced emissions.
- (d): A national medium to long term technology strategy for the development and adoption of commercially viable low emission or greenhouse mitigation technologies is a critical element of the approach industry proposes. Such a strategy should take account of research and development activities being pursued by Australian operating companies in a global context. Research funded by industry and government might include:
- geo-sequestration of carbon dioxide (underway via CO2CRC);
  - development of distributed energy technologies based on gas and also the development of technologies to allow their effective incorporation into the national grid;
  - use of high efficiency combined cycle turbines;
  - developing efficient end-use gas based technologies (e.g. gas fueled air conditioning);
  - further development of fuel cell technology;
  - implementing outcomes of the national hydrogen study;
  - research into more efficient and cost effective pipeline construction technologies, gas processing and industrial processes; and
  - testing by industry of the commercial practicality of developing electricity generation based on hot dry rocks, which depend on petroleum industry related technology.

APPEA would argue that Australia should not seek to be the world leader in all of these areas. Rather, it should pursue a series of specific international bilateral and multilateral technology agreements where there are discernible benefits to all parties. Government needs to be careful to avoid trying to "pick winners" and should instead concentrate on setting the right policy framework to facilitate scientific and technological innovation and eliminate barriers to the adoption of suitable, commercially viable technologies. Research and development into abatement technologies should be encouraged through funding and fiscal incentives and supported through policy. The pursuit of global corporate partnerships potentially offers benefits in this regard (for example, to allow Australian researchers to tap into the development of components for hybrid cars or fuel cell technology).

#### ***Longer Term Policy Principles***

APPEA believes that immediate and medium term responses should be flexible, least cost and consistent with development in the longer term of policies and measures which:

- will ensure efficient and effective market operations nationally and globally; and
- maintain the international competitiveness of trade exposed industries.



AUSTRALIAN PETROLEUM PRODUCTION & EXPLORATION  
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# EXPOSURE DRAFT OF THE CARBON POLLUTION REDUCTION SCHEME LEGISLATION

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APPEA Submission

APRIL 2009



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## 1. INTRODUCTION

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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](http://www.appea.com.au)<sup>1</sup>.

### 1.1 Introduction

APPEA has been engaged in the greenhouse policy debate since its inception and has, for example, participated in every major consideration of emissions trading schemes in Australia, commencing with the Australian Greenhouse Office discussion paper series in 1999 and including, more recently, the work of the States and Territories through the National Emissions Trading Task Force from 2005 to 2008, the work of the Prime Ministerial Task Group on Emissions Trading in 2006 and 2007, the work of the Garnaut Climate Change Review in 2007 and 2008 and the Carbon Pollution Reduction Scheme Green Paper and White Paper process in 2008.

With that in mind, APPEA welcomes the opportunity to provide a submission on the Exposure Draft of the Carbon Pollution Reduction Scheme legislation.

APPEA is also a member of the Australian Industry Greenhouse Network (AIGN), a network of industry associations and individual 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<sup>2</sup>. APPEA has contributed to the AIGN submission on the draft legislation.

In addition to the APPEA submission, a number of APPEA members have made individual submissions on the draft legislation. APPEA's members have a range of views on greenhouse policy, and on emissions trading schemes in particular, and this response should be read in conjunction with submissions from individual APPEA members. APPEA commends these submissions to you.

### 1.2 The role of Australia's oil and gas industry in Australia's greenhouse response

APPEA, and its members, are committed to working towards a profitable, safe, environmentally responsible and socially responsible oil and gas exploration, development and production industry.

Governments need to continue to recognise that greenhouse policies, including any consideration of an emissions trading scheme, such as that proposed by these draft Bills, must allow Australian industry to maintain its international competitiveness.

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<sup>1</sup> A list of APPEA's full member companies can be found at [www.appea.com.au/index.php?option=com\\_content&task=view&id=281&Itemid=264](http://www.appea.com.au/index.php?option=com_content&task=view&id=281&Itemid=264).

<sup>2</sup> See [www.aign.net.au](http://www.aign.net.au) for further information.

As part of its commitment to addressing greenhouse issues, APPEA was an original signatory to the Greenhouse Challenge Program in 1996<sup>3</sup>. Greenhouse Challenge (now Greenhouse Challenge Plus) members from the upstream oil and gas industry have abated over 22 million tonnes (Mt) of carbon dioxide equivalent (CO<sub>2</sub>-e) since that time. Overall, emissions from the upstream oil and gas industry account for less than 4 per cent of Australia's total emissions.

APPEA works with governments and other stakeholders to achieve credible industry actions and governmental greenhouse policies that address greenhouse concerns in an economically viable way, including ways to maintain international competitiveness. As part of this, the upstream oil and gas industry's *Greenhouse Response Strategy* is a public statement, released in November 2003, of the industry's approach to greenhouse policy. A copy of the APPEA *Greenhouse Response Strategy* can be found at **Attachment 1**<sup>4</sup>.

In addition, the industry, in 2006, embarked on the development of an Upstream Oil and Gas Industry Strategy. Led by APPEA in consultation with State, Territory and Australian Governments, the objective of the Strategy is:

*... to ensure the value of Australia's oil and gas resources to the Australian people is maximised, petroleum energy security delivered and long-term sustainability of an Australian oil and gas industry assured.*

The Strategic Leaders' Report, *Platform for Prosperity*, was released in April 2007<sup>5</sup> and provides an overview of the opportunities and challenges facing the Australian upstream oil and gas industry, the issues that could prevent these opportunities from being fully realised, and the options for addressing these issues.

This include greenhouse issues, where the report noted that Australia should consider the introduction of a market mechanism – for example, a national emissions trading system, linked to an international regime that places a price on carbon – to incorporate the economic, environmental and social costs and benefits of energy resources in a way that does not increase costs for trade-exposed industries. It is important to note that this position pre-dates any of the recent consideration of an emissions trading scheme in Australia.

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<sup>3</sup> Greenhouse Challenge Plus is designed to reduce greenhouse gas emissions, accelerate the uptake of energy efficiency, integrate greenhouse issues into business decision-making and provide more consistent reporting of greenhouse gas emissions levels. The APPEA Chief Executive is currently the Industry co-Chair of the Industry-Government Greenhouse Partnership Committee, that provides a forum for consultation on the key issues impacting on Greenhouse Challenge Plus and to ensure the effective development and operation of the program. (see [www.environment.gov.au/settlements/challenge/members/iggpc.html](http://www.environment.gov.au/settlements/challenge/members/iggpc.html)) for further information.

<sup>4</sup> The *Greenhouse Response Strategy* can also be downloaded from the APPEA website, at [www.appea.com.au/content/pdfs\\_docs\\_xls/PolicyIndustryIssues/APPEAGreenhouseResponseStrategyNov03.pdf](http://www.appea.com.au/content/pdfs_docs_xls/PolicyIndustryIssues/APPEAGreenhouseResponseStrategyNov03.pdf).

<sup>5</sup> See [www.appea.com.au/index.php?option=com\\_content&task=blogcategory&id=79&Itemid=81](http://www.appea.com.au/index.php?option=com_content&task=blogcategory&id=79&Itemid=81) for further information about the Industry Strategy process and [www.appea.com.au/content/pdfs\\_docs\\_xls/IndustryStrategy/Strategic%20Leaders%20Report.pdf](http://www.appea.com.au/content/pdfs_docs_xls/IndustryStrategy/Strategic%20Leaders%20Report.pdf) for a copy of the *Platform for Prosperity* report.

With this in mind, APPEA's submission has been generally organised to address specific sections of the Exposure Draft Bills and associated Commentary. However, the submission does not directly address every aspect of the draft legislation. Rather, it focuses on those areas that are particularly important for Australia's upstream oil and gas industry.

Very importantly, APPEA's comments are also made within the context of the pre-election commitments<sup>6</sup> provided by the Government, that included to:

- *ensure that Australia's international competitiveness is not compromised by Australia's response to climate change;*
- *ensure that Australian operations of emission intensive trade exposed firms are not disadvantaged by emissions trading; and*
- *consult with industry about the potential impact of emissions trading on their operations to ensure they are not disadvantaged.*

The vital nature of these commitments will be further considered in Section 2.1.

## 2. COMMENTS ON THE BILLS

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Many areas of the Bills are supported by APPEA and many have benefited from the consultation process that has been undertaken. This is not true in all cases, however. As noted above, APPEA's comments on the draft legislation focus on specific areas where amendments are required.

### 2.1 Treatment of emissions-intensive trade-exposed (EITE) activities (Division 8 of the draft *Carbon Pollution Reduction Scheme Bill 2009*): the role of liquefied natural gas (LNG) as a cleaner global contributor

APPEA notes Division 8 of the Bill sets out, in six pages, the proposed treatment of EITE activities. Almost all of the key details of the treatment are proposed to be set out in regulations and not in the Act itself.

APPEA recommends the treatment of EITE activities be included in the Act itself and not relegated to regulations.

#### 2.1.1 General comments

As has been considered and accepted by every major credible analysis of an emissions trading scheme undertaken in Australia and internationally, if policies and measures such as emissions trading schemes are implemented in some countries and not in others, there are distortions that can occur as a result of the escalation in production costs in the countries that have implemented greenhouse policies relative to those that have not.

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<sup>6</sup> Australian Labor Party (2007), *Labor's Plan for a Stronger Resources Sector*, 22 November (available at [www.alp.org.au/download/now/071122\\_labors\\_plan\\_for\\_a\\_stronger\\_resources\\_sector222.pdf](http://www.alp.org.au/download/now/071122_labors_plan_for_a_stronger_resources_sector222.pdf)).



APPEA has long recommended 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 emissions-intensive trade-exposed 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, the industry's key objective in considering this issue is to ensure that the Australian LNG industry does not bear an additional cost impact for as long as our competitors and customers are not subject to a similar impost.

The importance of this issue cannot be underestimated: a domestic emissions trading scheme would 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 draft Bills fail to achieve this outcome and require significant amendment.

### *2.1.2 Treatment of the LNG industry under Division 8 of the draft Carbon Pollution Reduction Scheme Bill 2009*

APPEA acknowledges that the Government, through the White Paper, has taken some steps to clarify the impact of the proposed emissions trading scheme on Australia's LNG industry.

This means that provided it meets the criteria set out in the Commentary at paragraph 4.12, LNG may qualify for an administrative allocation of permits to cover up to nominally 60 per cent of emissions in the first year of the scheme's operation.

It remains the case, however, that the industry will be subject to a significant cost burden that is not borne by its LNG competitors<sup>7</sup> or customers. Reducing the international competitiveness of Australia's LNG industry will lead to growth prospects being constrained and a likely commensurate increase in global emissions as developing countries continue to expand their use of more carbon intensive fuels.

In this context, arguments that the industry can "afford to pay" are economically naive and fail to recognise the range of factors that influence investment decisions in the Australian LNG industry.

Discussions around a perceived capacity to pay convey an unfounded confidence that companies with multiple global investment choices will invest in

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<sup>7</sup> Australia's LNG industry faces fierce global competition. Australia's major LNG competitors include Qatar, Algeria, Nigeria, Trinidad and Tobago, Egypt, Brunei, Indonesia, Malaysia, Oman and the United Arab Emirates.

new Australian LNG projects. Carbon costs of the kind illustrated implied by the Scheme would represent a substantial addition to operating costs and a substantial reduction in profit margin.

Most importantly, with competitors not facing comparable costs, the decision about which project proceeds next and whether a particular project proceeds at all, may be affected. The omitted or deferred investment funds would be spent elsewhere in the world, and no global emissions benefit would have been achieved.

Good policy design is not about profitability. Proposals that treat firms or industries differently based on profitability undermine the integrity of the overall scheme design. Designing an effective and efficient scheme to meet the (appropriately amended as recommended below) Objects of the Bill is not reliant on and should not be reflective of industry profitability.

Design of the Scheme should be focused on the long-term viability of industries that would expand if a global emissions trading scheme were in place, not on the short-term profits over the course of a business cycle peak.

APPEA noted in its submission to the Carbon Pollution Reduction Scheme Green Paper<sup>8</sup>, the Senate Select Committee on Fuel and Energy<sup>9</sup>, the Senate Standing Committee on Economics<sup>10</sup> and the Senate Select Committee on Climate Policy<sup>11</sup> that it would be unfortunate if, by unnecessarily constraining Australia's LNG industry, the design of the emissions trading scheme were inadvertently to undermine the Scheme's ultimate objective of helping the world to reduce greenhouse gas emissions.

LNG has been characterised as an 'anomaly' within the emissions trading scheme design. Although producing LNG is emissions intensive and adds to greenhouse gas emissions in Australia, natural gas makes a substantial net contribution to reducing global greenhouse gas emissions. As the world inevitably shifts to a preference for cleaner burning fuels, the substantial strategic value of Australia's natural gas assets can only increase.

The following diagram illustrates the point. Analysis undertaken by CSIRO<sup>12</sup> in 1996, WorleyParsons<sup>13</sup> in 2008 and PACE<sup>14</sup> in 2009, shows that although LNG

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<sup>8</sup> APPEA's submission to the Carbon Pollution Reduction Scheme Green Paper can be found at [www.climatechange.gov.au/greenpaper/consultation/pubs/0834-appea.pdf](http://www.climatechange.gov.au/greenpaper/consultation/pubs/0834-appea.pdf).

<sup>9</sup> APPEA's submissions to the Senate Select Committee on Fuel and Energy can be found at [www.aph.gov.au/Senate/committee/fuelenergy\\_ctte/submissions/Sub0018.pdf](http://www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/Sub0018.pdf), [www.aph.gov.au/Senate/committee/fuelenergy\\_ctte/submissions/sub0018a.pdf](http://www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/sub0018a.pdf) and [www.aph.gov.au/Senate/committee/fuelenergy\\_ctte/submissions/sub0018b.pdf](http://www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/sub0018b.pdf).

<sup>10</sup> APPEA submission to the Senate Standing Committee on Economics can be found at [www.aph.gov.au/senate/committee/economics\\_ctte/cprs\\_09/submissions/sub111.pdf](http://www.aph.gov.au/senate/committee/economics_ctte/cprs_09/submissions/sub111.pdf) and [www.aph.gov.au/senate/committee/economics\\_ctte/cprs\\_09/submissions/sub111a.pdf](http://www.aph.gov.au/senate/committee/economics_ctte/cprs_09/submissions/sub111a.pdf) and [www.aph.gov.au/senate/committee/economics\\_ctte/cprs\\_09/submissions/sub111b.pdf](http://www.aph.gov.au/senate/committee/economics_ctte/cprs_09/submissions/sub111b.pdf).

<sup>11</sup> APPEA's submission to the Senate Select Committee on Climate Policy can be found at [www.aph.gov.au/senate/committee/climate\\_ctte/index.htm](http://www.aph.gov.au/senate/committee/climate_ctte/index.htm).

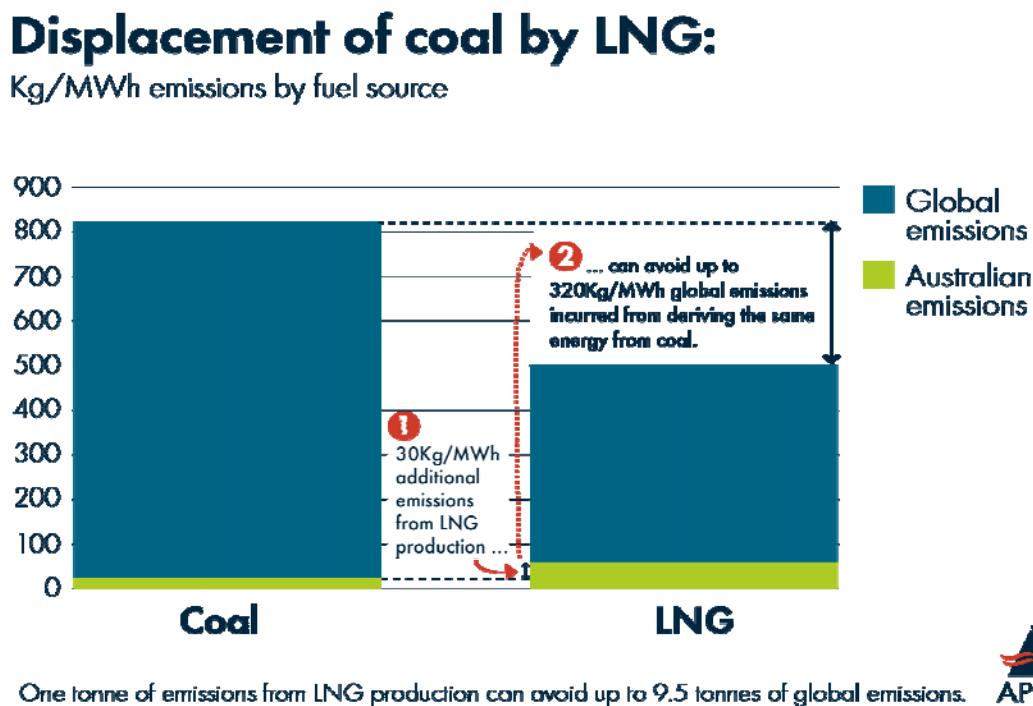
<sup>12</sup> CSIRO (1996), *Lifecycle emissions and energy analysis of LNG, oil and coal*, December.

<sup>13</sup> WorleyParsons (2008), *Greenhouse Gas Emissions Study of Australian LNG*, July.

<sup>14</sup> Center for Liquefied Natural Gas (2009), *Life Cycle Assessment of GHG Emissions from LNG and Coal Fired Generation Scenarios: Assumptions and Results*, PACE, Fairfax, Virginia, US, February.

production requires energy and is itself emissions-intensive, for every tonne of greenhouse gas emitted in the production of Australian LNG, between 4 and 9½ tonnes of greenhouse gas emissions are avoided in customer countries if LNG is used to displace higher emission fuels in electricity generation.

Figure 1: Greenhouse emissions benefits associated with Australia’s LNG exports



Source: CSIRO, WorleyParsons.

Realising the full economic and environmental potential of Australia’s natural gas requires a commitment from both Government and industry to identifying and removing impediments to its development. LNG is a proven industry with significant and imminent growth prospects in Australia. The impact of this industry’s growth on regional development and employment, as well as Government earnings is set to be substantial.

APPEA agrees with Professor Ross Garnaut<sup>15</sup> that a fundamental principle in designing a domestic emissions trading scheme 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.

APPEA was therefore disappointed that an important rationale for permit allocation to EITE activities outlined in the Green Paper was subsequently removed in the White Paper and is not reflected in the objects of this Part of the Bill at Section 165. The third rationale for recognising EITEs in the Green paper was “to support production and investment decisions that would be consistent with a global carbon constraint”. This has been removed as a principle and

<sup>15</sup> Garnaut, Professor Ross (2008), *The Garnaut Climate Change Review: Final Report*, 30 September (available at [www.garnautreview.org.au/index.htm](http://www.garnautreview.org.au/index.htm)).

transformed into a vague statement of expectation that this may be a partial consequence of EITE treatment. It is not reflected in Section 165 of the Bill at all.

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. Yet, the domestic scheme, as proposed, would see the industry's growth, growth that is both economically efficient and environmentally effective, constrained.

The LNG industry can think of no explanation for a design that results in a cost burden for an Australian industry that is poised for growth precisely because of the world's desire for less greenhouse gas emitting sources of energy. Inadvertently, it could send a message that Australia is unconcerned that this growth, and all the environmental, economic and social benefits associated with it, will occur, instead, in those LNG producing countries with which we compete.

Australian LNG industry growth is also consistent with Government policy. For example, in his recent visit to South Korea, the Minister for Resources, Energy and Tourism, the Hon Martin Ferguson AM MP, stated<sup>16</sup>

*Understand that in the important transition to a low carbon economy, LNG will become exceptionally important ...*

*This is very important for Korea, as it goes to the heart of energy security for Korea and a great opportunity to work together on our mutual priorities ...*

*We are currently only meeting part of Korea's LNG needs, but there is a rich, mutually beneficial opportunity to improve this situation.*

There is a global environmental benefit to encouraging the expansion of the natural gas industry, including cleaner global contributors like Australian LNG. Under a global carbon constraint, natural gas and the LNG industry could be expected to expand and Australia could play a key role in that global growth. The Bill however, only partly recognises the potential of domestic gas and fails to recognise cleaner global contributors, particularly LNG, when contemplating national and international reduction targets.

In many cases, project proponents will receive substantially less than a 60 per cent permit allocation as a consequence of directly linking permit allocation to production. This linkage, whilst potentially appropriate in considering the liquefaction plant itself, penalises developments that are based on gas fields with higher reservoir carbon dioxide content than existing projects, even though differences in reservoir emissions are small in relation to the global emission reductions that the greater utilisation of natural gas will deliver and the project proponents have no control over the carbon dioxide content (such content being a function of the geology of the reservoir itself).

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<sup>16</sup> See [www.koreaherald.co.kr/NEWKHSITE/data/html\\_dir/2009/04/13/200904130049.asp](http://www.koreaherald.co.kr/NEWKHSITE/data/html_dir/2009/04/13/200904130049.asp) for further information.

The case for the industry not to be exposed to any cost associated with a domestic emissions trading scheme while our competitors and customers (with cheaper, higher emitting energy choices available) are not subject to similar imposts is compelling.

### *2.1.3 The way forward: options to provide an appropriate treatment of emissions-intensive trade-exposed industries*

Clearly, significant amendments to Division 8 of the draft *Carbon Pollution Reduction Scheme Bill 2009* are required.

APPEA recommends the draft *Carbon Pollution Reduction Scheme Bill 2009* be amended to ensure the LNG industry does not face any cost associated with a domestic emissions trading scheme while ever our competitors and customers (with cheaper, higher emitting energy choices available) are not subject to similar imposts.

- This could be achieved, for example, by ensuring an administrative allocation of permits of 100 per cent of direct ('scope 1') emissions and 100 per cent of permits needed to fully offset costs passed-through by non-trade exposed industry (typically in electricity prices, gas prices and feedstock prices).
- It would also require removal of the allocation 'decay' of 1.3 per cent per annum (the so-called 'carbon productivity contribution').
- Permit allocation should be made to existing operations based on fixed relationships between output and direct emissions and non-trade exposed cost pass-through measured in a typical recent year or average of years.

As has been noted by AIGN in its submission, if permit allocation was based on trade exposure, then the complicated design elements involving 'emission intensity' tests and narrow and artificial definitions of 'activity' are not required.

In addition, analysis prepared for APPEA by Access Economics<sup>17</sup>, shows that providing a 100 per cent permit allocation will result in the continued growth of the LNG industry in Australia and a reduction in the growth in global emissions. It shows that, in all cases analysed<sup>18</sup>, the economic growth benefits of an expanding LNG industry outweigh any costs associated with the permit allocation.

In addition, providing permits to the LNG industry does not 'shift the burden' onto other sectors of the Australian economy. The LNG industry exports 100 per cent of its relevant production. This makes LNG unique in an economic sense, in that,

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<sup>17</sup> Access Economics (2009), *Indicative costs and benefits of a LNG emissions costs offset*, January (available at [www.appea.com.au](http://www.appea.com.au)).

<sup>18</sup> The scenarios modelled were those used in the Treasury modelling report, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation*, included the four scenarios modelled by the Treasury (known as "CPRS -5", "CPRS -15", "Garnaut -10" and "Garnaut -25").

all production takes place domestically but is consumed in foreign markets. As such, the LNG industry does not fit with standard economic analysis that has been applied to this issue in the public debate.

There are two parts to 'burden shifting':

- first, when the carbon the price of the good is passed onto consumers and downstream industries (without compensation); and
- secondly, the incentives of the LNG sector to undertake abatement measures.

On the first point, the North West Shelf and Darwin LNG facilities and the other export facilities under consideration have no domestic consumers, either industry or households. If you have no domestic consumers higher costs are not passed to domestic consumers. No other sector will be asked to carry a heavier burden in terms of paying a higher price should permits be administratively allocated to LNG.

On the second point, whether or not permits are administratively allocated or through auctioning the LNG industry has the same incentive to reduce emissions. As will be considered further below, a permit that is administratively allocated has an opportunity cost – this means that the firm will make a decision on whether to acquit the permit or undertake abatement and sell the permit in the market.

As the Commentary to the draft Bill notes at paragraph 4.6 *"... the opportunity cost of each Australian emissions unit to a firm is the same ..."* regardless of whether they are allocated or purchased at auction or on the secondary market – they are not 'free'.

A number of additional amendments to the draft Bill are also required:

- Section 165(e) and (f) should be deleted. Section 165(e) is focussed on large emitting countries, when the real issue for EITE industries is the action of competitors – this is captured in Section 165(d);
- a new object should be added to Section 165 to reflect that a fundamental principle in designing a domestic emissions trading scheme 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; and
- references to 'free' permits should be removed and replaced by 'administratively allocated'. As was noted above, the opportunity cost of each Australian emissions unit to a firm is the same regardless of whether they are allocated or purchased at auction or on the secondary market – they are not 'free'.

## 2.2 Objects of the draft *Carbon Pollution Reduction Scheme Bill 2009* (Section 3)

APPEA notes that the Objects of the *Carbon Pollution Reduction Scheme Bill 2009*, as set out in Section 3, only partly reflect the appropriate policy objectives of the Bill and its role in greenhouse policy development.

APPEA therefore recommends the objects of the *Carbon Pollution Reduction Scheme Bill 2009* be expanded to include that it should:

- impose a price on emissions;
- offset competitive disadvantage for emissions-intensive trade-exposed industries; and
- replace existing measures no longer required in the presence of a price on greenhouse gas emissions.

## 2.3 National scheme cap and National scheme gateway (Section 14(5)(b), (c) and Section 15 of the draft *Carbon Pollution Reduction Scheme Bill 2009*)

At Section 14(5)(b) and Section 15 the matters that the Minister 'must' take into account in setting the five year caps and ten year gateways include the report (if any) of the Expert Review Committee. APPEA notes the Expert Review Committee does not allow appointment of a person that is working/has worked for a liable party.

APPEA recommends the Bill be amended so that rather than having an ad hoc Expert Review Committee established, the Productivity Commission be appointed to undertake these Reviews.

In addition, APPEA notes the matters that the Minister 'may' take into account in setting the five year caps and ten year gateways is limited under Section 14(5)(c) and 15. Specifically, these Sections include no definitions of major/advanced economies, no definition of voluntary action and no methodology for increasing coverage.

APPEA recommends that these matters be added to the list of matters that the Minister 'may' take into account in setting the five year caps and ten year gateways under Section 14(5)(c) and 15. Specifically:

- the definition of 'advanced' should accord with Australia's submission to the United Nations Framework Convention on Climate Change (available at [www.climatechange.gov.au/international/unfccc-submissions.html](http://www.climatechange.gov.au/international/unfccc-submissions.html)), that is, all economies with GDP per head greater than Ukraine; and
- the definition of 'voluntary action', should accord with Part 14, 'voluntary cancellation'.



In addition, at Subsection 15(2), the Minister 'may', but need not, set 10 year gateways.

APPEA recommends that the Bill be amended to require the Minister to set the 10 year gateways.

#### **2.4 Amendments to Corporations Act 2001 and Australian Securities and Investments Commission Act 2001 (Schedule 1, Part 1, item 4-6 and Schedule 1, Part 1, item 1 of the draft Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009)**

The amendments contained in Schedule 1, Part 1, item 4-6 and Schedule 1, Part 1, item 1 of the *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009* will mean Australian emissions units and eligible international emissions units are to be financial products for the purposes of the Chapter 7 of the *Corporations Act 2001* and Division 2, Part 2 of the *Australian Securities and Investments Commission Act 2001*.

APPEA notes the Commentary to the Bill states that:

*These amendments will provide a strong regulatory regime to reduce the risk of market manipulation and misconduct. Appropriate adjustments to the regime to fit the characteristics of units and avoid unnecessary compliance costs will be made. Further consultation will be undertaken on the adjustments that will be necessary.*

While, as noted above, the lack of detail about the 'adjustments' to be made make it very difficult to comment on these proposed amendments, APPEA notes that if these units are categorised as 'financial products', many liable entities will need to obtain Australian Financial Services Licences (AFSL) in order to participate in the relevant markets. Obtaining an AFSL can be a significant process taking upwards of six months with major ongoing compliance issues.

APPEA recommends the Department undertake this consultation as a matter of urgency with the overarching aim of this part of the amendments being to minimise initial and ongoing compliance costs for liable entities.

#### **2.5 Obligation Transfer Numbers (Division 5 of the draft Carbon Pollution Reduction Scheme Bill 2009)**

APPEA has previously noted its general support for the obligation transfer number (OTN) system, outlined in Chapter 6 of the White Paper. In particular, APPEA has supported policy position 6.11<sup>19</sup>, that states:

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<sup>19</sup> Australian Government (2008), *Carbon Pollution Reduction Scheme White Paper*, page 6-25, December (available at [www.climatechange.gov.au/whitepaper/index.html](http://www.climatechange.gov.au/whitepaper/index.html)).

***Policy position 6.11***

*Scheme obligations for emissions from domestic combustion of natural gas and other gaseous fuels will apply to entities that first supply these gases for use in the domestic market.*

*Certain suppliers and users of natural gas may use an OTN when purchasing fuel and directly manage permit liabilities. Note that natural gas retailers will be required to use an OTN and that Scheme obligations will transfer, with natural gas supplies, to these entities.*

APPEA's intent in assessing Division 5 of the draft *Carbon Pollution Reduction Scheme Bill 2009* as it relates to the upstream oil and gas industry has, therefore, focussed on ensuring the draft Bill gives appropriate effect to policy position 6.11.

APPEA's assessment, in the time available, and as a result of consultation with the Department and involvement in the OTN "stress testing" workshop held in Canberra on 9 April 2009, suggests that the Division does broadly achieve this, subject to clarification of a number of matters. In addition to the issues set out below, APPEA notes that a number of its members have provided detailed comments on the OTN system. APPEA's comments should therefore be viewed as a supplement to these more detailed comments.

***2.5.1 Obligation Transfer Numbers: treatment of direct exports of eligible upstream fuels (Sections 60-62 of the draft Carbon Pollution Reduction Scheme Bill 2009)***

Chief among these is the treatment of direct exports of eligible upstream fuels (as defined in Section 5 of the draft *Carbon Pollution Reduction Scheme Bill 2009*), including the export of LNG. Exports of LNG (to customers in countries such as Japan, China and South Korea) are made directly by the companies involved and not sold to intermediaries (as may be the case in other industries).

Section 62 provides that if during an eligible financial year, a person supplies an amount of a prescribed type of eligible upstream fuel to another person and the recipient carries on a business of exporting or re-supplying that type of eligible upstream fuel, then the recipient may quote the recipient's OTN in relation to the supply.

The Commentary to the draft *Carbon Pollution Reduction Scheme Bill 2009*, at paragraph 1.234, states:

*1.234 Intermediaries in the coal supply chain and liquefied natural gas supply chain will be permitted to quote an OTN. [Part 3, Division 5, clauses 60-61] The regulations will allow for inclusion of intermediaries for additional fuel types where this is needed to allow downstream entities to assume liability for fuel supplied to them, or where an intermediary exports fuel. [Part 3, Division 5, clause 62]*

There are two issues with these Sections and paragraph 1.234 of the associated Commentary:

- Section 61 relates to liquefied petroleum gas, not LNG as stated in the Commentary; and
- in any event, each of Sections 60 to 62 is predicated on the existence of an intermediary to whom the eligible upstream fuel (such as LNG) is supplied before it is exported. If this does not occur, and the export is made directly, the draft Bill is unclear as to how this export is to be treated.

If the implication of these Sections is that the overseas customers receiving that eligible upstream fuel must obtain and quote an OTN, this is clearly an unacceptable outcome that must be avoided.

APPEA recommends:

- the error in the Commentary at paragraph 1.234 of the *Carbon Pollution Reduction Scheme Bill 2009*, be corrected before the Explanatory Memorandum to the Bill is prepared; and
- the Bill be amended to make it clear that a direct export of an eligible upstream fuel, such as LNG, to an overseas customer does not require that overseas customer to obtain and quote an OTN.

### *2.5.2 Obligation Transfer Numbers: quotation after contract entered into (Sections 51-52 of the draft Carbon Pollution Reduction Scheme Bill 2009)*

An additional issue that came to light during the 9 April 2009 workshop with the Department relates to the quotation of an OTN after a contract has been entered into. The scenario set out at the workshop was as follows:

- X enters into a contract on 2 July 2010 for the supply of an eligible upstream fuel to Y.
- Y has been issued an OTN. At the time of entering into the contract, Y does not know how much of the supplied fuel will be combusted at the facility Y operates. Y is not sure whether its combustion of the fuel will result in emissions of more than 25,000 tonnes CO<sub>2</sub>-e. Accordingly, Y does not quote its OTN to X before the contract is entered into.
- Y's combustion of the fuel on 15 May 2011 results in emissions of 30,000 tonnes CO<sub>2</sub>-e. Y realises that it is required under Section 52 to quote an OTN in relation to the supply of the fuel. However, it is unable to do so as the contract has already been entered into.

APPEA is therefore concerned about the impact on members in situations where natural gas purchasers have emissions levels that may move above and below the 25,000 tonnes CO<sub>2</sub>-e per annum emissions threshold during the course of a long-term gas supply contract.

For example, in a situation where an upstream gas supplier has entered into a multi-year contract to supply gas to a purchaser whose consumption of the gas is expected to generate emissions in excess of 25,000 tonnes CO<sub>2</sub>-e. Accordingly, the contract has been agreed on the basis of an OTN being quoted by the purchaser for the duration of the contract – and the gas price and terms are consistent with the purchaser being the liable entity for the carbon emissions from the use of the gas supplied under the contract.

In a situation where, several years into the contract, during the previous financial year the purchaser had installed some new equipment and/or had a maintenance shutdown resulting in their emissions for the year falling below the 25,000 tonnes CO<sub>2</sub>-e threshold. This might be a once-off occurrence, or it could mark a permanent reduction in annual emissions for the remainder of the contract term. The purchaser tells the supplier that it has withdrawn its OTN quotation, and that the Scheme obligations for embedded emissions in the natural gas are the responsibility of the upstream supplier – this could apply just for the past financial year and/or apply for all subsequent years remaining on the contract term.

This results in a risk for the upstream supplier that is very difficult to manage contractually, as the embedded carbon costs are not easy to define at the time of contract negotiation. For example, all liable entities will have their own approach to managing their permit obligations resulting in different carbon cost outcomes for each liable entity. Further, given that the upstream supplier may discover very late in the relevant compliance period that it is liable to acquit for the previous financial year's embedded emissions, the upstream supplier may have only limited and costly options available to it in order to secure the necessary permits in time for acquittal.

The reverse of this scenario could also happen. The gas sales contract could be written on the basis that the purchaser's annual emissions would be below the 25,000 tonnes CO<sub>2</sub>-e threshold, however part-way through the contract term the purchaser's emissions might then exceed the threshold. The purchaser could then quote an OTN to the upstream supplier with a request for a contract renegotiation. Such a negotiation will be potentially costly and time consuming for both parties.

In order to avoid the risks outlined above, APPEA recommends the draft Bill be amended to stipulate that the basis for the gas sales contract (that is, whether an OTN is to be quoted or OTN is not to be quoted by the gas purchaser) at the time of contract execution will remain in place for the duration of the contract, irrespective of if and how the actual emissions of the purchaser vary during the contract term.

This approach means there are no gaps in the Scheme and a potentially costly and high risk contractual issue is avoided.

Long-term gas contracts underpin the vast majority of new gas developments in Australia. It would be a perverse outcome if, through an unintended side effect of the OTN approach, Australian gas developments were stymied and opportunities to replace high emissions fuels with low emissions natural gas were lost.

**2.6 Liabile entity—supply of untransformed eligible upstream fuel (other than liquid petroleum fuel) and Liabile entity—supply of transformed eligible upstream fuel (Part 3, Division 4, Sections 33 and 35 of the draft *Carbon Pollution Reduction Scheme Bill 2009*)**

An unintended consequence for exports, such as exports of LNG, supplied to overseas customers on a free-on-board (FOB) basis<sup>20</sup>, may arise from the wording of Sections 33 and 35. Based on the wording contained in the draft Bill, it could be interpreted that LNG delivered on an FOB or similar basis in Australian waters, would be liable for the potential emissions embodied in the LNG even though they occur overseas. This is clearly not an intended outcome of the OTN system embodied in the Bill.

The issue appears to APPEA to revolve around the definition proposed for when supply occurs for a substance other than pipeline gas and the fact that the Bill deems that to be when the substance is physically delivered. This issue has been dealt with under the *A New Tax System (Good and Services Tax) Act 1999*, that recognises FOB exports as GST-free exports and not subject to the Australian GST regime, even though delivery occurs to the overseas customer on an FOB or similar basis.

APPEA notes the comments reported<sup>21</sup> on 16 April 2009, where a spokeswoman for the Minister for Climate Change and Water, Senator the Hon Penny Wong, is reported as stating such an outcome would not occur as

*... it was contrary to normal legal interpretation to suggest liability for emissions would reach beyond Australia's shores.*

While APPEA welcomes this assertion, it remains the case that the uncertainty caused by Sections 33 and 35 would be best addressed by directly amending it rather than relying on what might or might not be "normal legal interpretation".

APPEA therefore recommends Sections 33 and 35 be amended to ensure that exports provided on an FOB basis do not result in the exporter being liable for potential emissions embodied in the LNG even though they occur overseas.

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<sup>20</sup> FOB means that the seller delivers when the goods pass the ship's rail at the named port of shipment. This means that the buyer has to bear all costs and risks of loss of or damage to the goods from that point. The FOB term requires that the seller clears the goods for export. This term can only be used for sea or inland waterway transport. See [www.iccwbo.org/incoterms/id3045/index.html](http://www.iccwbo.org/incoterms/id3045/index.html) for further information.

<sup>21</sup> Breusch, J. (2009), "Critics fuel debate over emissions trading scheme", *The Australian Financial Review*, 16 April, p. 5.

## 2.7 Purchase and Acquittal of Compliance Permits – Unincorporated Joint Ventures (Section 11B and 11C of the draft *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009*)

Upstream oil and gas industry projects in Australia are generally undertaken by way of 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 does not necessarily lead to the creation of a legal entity. Under the JOA, the parties (or participants) appoint an operator to manage and undertake joint venture activities on behalf of the parties to the JOA. The operator provides a work program and budget to the participants, that is approved by a resolution of all participants, and subsequently applies for funding of the work program through separate authority (for expenditure) from all participants.

All assets of the joint venture are owned jointly by the participants, however liabilities are several and not joint or collective. This requires each participant to be responsible only for its individual obligations. Participants have an entitlement under the JOA to take in kind their participating share of production. The model is common world-wide.

The *National Greenhouse and Energy Reporting Act 2007* indicates the corporation with “operational control”, or a party nominated by the joint venture, of a facility has liability to report emissions in respect of that facility. The controlling corporation will be in the best position to discharge the reporting obligations under the *National Greenhouse and Energy Reporting Act 2007*. Reporting and measuring aside, however, in the case of a UJV, the commercial, legal and financial obligations typically belong to each joint venture participant.

In the upstream oil and gas industry, the operator of the project generally executes the activities that lead to a resulting product, but they do not have ownership of the molecules, assets or resultant product (except to the extent of their own participating interest). Therefore, the controlling corporation (or operator) for reporting purposes should not be the person liable for meeting liabilities for the acquittal of emissions of a UJV.

It is important that 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 interest in the joint venture. Similarly, in the context of administratively allocated permits (such as those provided to EITE activities), they should be allocated to individual participants within UJVs, again on the basis of their interest in the joint venture. It is important to note that the ability to issue a Liability Transfer Certificate (considered in Division 6 of the draft *Carbon Pollution Reduction Scheme Bill 2009*) in respect of a facility does not resolve this issue.

The “push down” of liabilities to each underlying joint venture participant is also essential for the effective operation and administration of Australia’s fiscal rules.

For example, in the case of secondary taxation such as petroleum resource rent tax, the law 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 recommends that for activities undertaken within unincorporated joint ventures, specific reference be included within the legislation to ensure that the liability for acquittal rests with the individual joint venture participants in proportion with their interest in the joint venture. Participants with projects/activities being undertaken within unincorporated joint ventures be provided with flexibility in meeting their obligations to ensure that any final measures are complementary to the legal and commercial framework within which these structures operate.

## **2.8 Taxation amendments (Schedule 2 of the draft *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009*)**

APPEA notes that Schedule 2 of the draft *Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009* proposes a number of amendments to the *Income Tax Assessment Act* to give legislative effect to certain fiscal treatments for activities associated with the Scheme. APPEA believes tax treatments for costs and revenues need to be assessed against a number of key principles:

- expenditures or costs on abatement activities within a framework agreed by the government should be fully deductible;
- the taxation treatment of expenditures associated with permit acquisitions should be no different from the treatment of other eligible expenditures incurred by a person in the course of conducting business activities; and
- taxation treatments should not influence a party's decision in choosing between alternative methods to abate or acquit a greenhouse gas emissions liability. That is, a decision to pursue an abatement option should not be distorted through the application of the taxation treatment of that option.

APPEA recommends that the Treasury and the Department rigorously assess the proposed taxation outcomes against the above criteria to ensure that the fiscal framework does not act to distort decisions associated with alternative abatement actions undertaken by parties operating under the Scheme.

## **2.9 Accounting for registered emissions units you hold at the start of or end of the income year (permits issued under Part 10 of the draft *Carbon Pollution Reduction Scheme Act 2009*)**

APPEA notes that for the purpose of Subsection 420-55 (1), permits issued under Part 10 of the *Carbon Pollution Reduction Scheme Act 2009* are valued at cost.



Cost is defined in Subsection 420-60(1) as the market value immediately after a taxpayer begins to hold the unit. The effect of this is that an amount will be included in a taxpayer's assessable income under Subsection 420-45(2) equal to the market value of such permits at the acquisition time if the permits were still held at the end of the year. This has the potential for adverse cash flow consequences for an entity as they will effectively be taxed on income they have not earned.

This issue has been recognised in relation to units issued under the EITE program with the insertion of a "no disadvantage rule" under Subsection 420-57 that operates to ensure that the value of such permits on hand at the end of the year is nil. In APPEA's view, there is no policy reason to differentiate permits issued as a result of carbon sequestration by reforestation from permits issued under the EITE program. To do so could affect an entity's commercial choice as to how they would choose to satisfy their obligations under the Scheme with generation of permits by carbon sequestration by reforestation coming with a cash flow cost.

APPEA recommends the Bill be amended to move wording at Subsection 420-57(1)(a) to 420-57(1)(a)(i) and replace "and" with "or" at the end of the sentence. APPEA further recommends that a Subsection 420-57(1)(a)(ii) be inserted as follows "it was issued to you in accordance with Part 10 (reforestation) of the *Carbon Pollution Reduction Scheme Act 2009*".

## **2.10 Australian boundaries (Paragraphs 1.278-1.282 of the Commentary to the draft *Carbon Pollution Reduction Scheme Act 2009*)**

APPEA notes that the Commentary to the draft Carbon Pollution Reduction Scheme Act 2009, at paragraph 1.282, says

*1.282 The Government is considering whether the Scheme should include specific provisions relating to activities in the Joint Petroleum Development Area and the Greater Sunrise Oil and Gas Field (and pipelines associated with them) in the light of Australia's international obligations. The final decision on this issue will be included in the final bill prepared for introduction.*

APPEA members are co-venturers in the Bayu-Undan Project, the Greater Sunrise Fields and in other Joint Petroleum Development Area (JPDA) Production Sharing Contracts containing undeveloped oil and gas discoveries. Hence APPEA members 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.

Should the Australian Government be considering seeking the application of the Scheme to the JPDA, it should investigate the potential negative effect this will have on the ability of Timor-Leste to attract investment to the JPDA as compared to other developing countries which do not have plans to impose a carbon cost at this time. The ramifications for Timor-Leste' development of imposing a carbon

cost well ahead of other developing countries should be carefully considered and include examining the potential negative development impacts for the Timor-Leste' people.

To gain a comprehensive understanding of the impacts from any proposed application of the Scheme to an international treaty area such as the JPDA, APPEA suggests the Australian Government consult with the Timor-Leste Government and a wide range of national and international stakeholders (oil and gas companies, international organisations, Timor-Leste civil society and others). APPEA recommends a comprehensive stakeholder engagement plan and timeline be developed to underpin these consultations.

### 3. OTHER ISSUES

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As noted above, a number of issues are not included with the draft legislation released on 10 March 2009. This severely 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 EITE activities and the lack of any regulatory detail, there are a number of other important issues not included in the draft legislation. These include (but are not limited to – other submissions will undoubtedly highlight additional issues):

- there appears to be no transparent process to determine the allocation of the national commitment among the covered (by the Scheme) and uncovered sectors;
- auction design. The Commentary to the *Carbon Pollution Reduction Scheme Bill 2009*, notes a paragraph 3.17

*The detailed policies, procedures and rules for the conduct of auctions will be included in a legislative instrument [Part 4, Division 2, clause 103]*

The Department has indicated a discussion paper will be issued at end of March 2009, but the discussion paper has not as yet (mid-April 2009) been released;

- international linking provisions; and
- export control provisions for the future sale and transfer of Australian emissions units to foreign registries. The Commentary to the *Carbon Pollution Reduction Scheme Bill 2009*, at paragraph 2.29, states

*2.29 Provisions that allow for the future sale and transfer of Australian emissions units to foreign registries (export) will be included in the final bill.*

The Commentary does not provide a reason for not including these provisions in the Package released on 10 March 2009.

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