



25 March 2009

Chair
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600

Dear Senator

Carbon Pollution Reduction Scheme (CPRS) Exposure Draft Legislation

The Australian Coal Association (ACA) represents Australia's black coal industry with ACA members responsible for 99 per cent of Australia's black coal production and all of its exports. In responding to the request for submission to the Standing Committee's inquiry the ACA will focus on four key issues in the White Paper:

- the purpose of the legislation;
- the establishment in the main CPRS Bill of the Emissions Intensive Trade Exposed (EITE) arrangements;
- the exclusion of the coal industry from these arrangements – the coal industry meets the White Paper eligibility criteria for a 60% permit allocation under the EITE arrangements and should receive EITE permit allocation consistent with the approach adopted for all other trade exposed industries. To ensure there are no windfall gains a simple allocation method is available to guarantee that coal companies do not make windfall gains from inclusion in the 60% EITE permit category and is illustrated in the **Attachment**; and
- energy security and the treatment of captured coal mines supplying thermal coal to domestic power stations under long term contracts.

1. Purpose of the legislation

The CPRS Bill includes three objects at clause 3. These objects are general in nature and while informative of Parliament's objective in enacting the legislation do not adequately explain the purpose of the highly detailed and complex legislative package. The objects should be made more complete and informative through specific reference to:

- an efficiently designed cap and trade emissions trading scheme (ETS) capable of being linked to both individual country and regional initiatives as these evolve to a more broad-based ETS;
- the ETS to be complemented by other efficient market-based mechanisms to encourage: technology development and deployment including Carbon Capture and Storage research, development and demonstration; energy efficiency; and adaptation;
- the imposition of a price on greenhouse gas emissions in Australia to promote structural reform in Australia while ensuring "Australia's international competitiveness is not compromised", "industry ... operations ... are not disadvantaged" and specific mechanisms are established "to ensure that Australian operations of emissions intensive trade exposed firms are not disadvantaged by emissions trading";¹
- the objective of offsetting the competitive disadvantage of the CPRS for trade exposed industry and to provide transitional arrangements until such time as Australia's major trade competitor countries impose similar requirements (to link in with improved objects for Part 8).

¹ ALP, Election Policy Document, *Labor's Plan for a Stronger Resources Sector*, November 2007, p 9.

These amendments would clarify the intention of the Government that the six bills making up the CPRS exposure draft legislation together with associated complementary measures “will provide the robust framework that is required to set up Australia’s economy for a low pollution future.”

The Government has also stated it “is very mindful of the need to deliver business certainty and a clear position in the lead up to the Copenhagen climate change conference. Passing the legislation during the 2009 winter sittings will deliver this certainty”. The ACA does not share this view. We have consistently maintained that the most important objective in implementing the CPRS is to ensure the framework is right and will stand the test of time. This will mean providing adequate time to the legislative process.

It needs to be recalled that the legislation and yet to be developed regulations seek to establish an emissions trading scheme for Australia that will impact all Australians over a period of many decades. What is required is:

- a) legislation that will stand the test of time; and
- b) a sound and enduring emissions trading scheme framework founded in sound public policy principles that have been clearly endorsed by Parliament and are capable of interpretation without ambiguity by Tribunals and Courts.

The ACA is concerned that insufficient time is being provided for comment on these highly complex Exposure Draft Bills and that the proposed implementation timetable will allow the Senate only two weeks of sittings to consider the Bills as presented from the House of Representatives. The Parliament will also only see a portion of the lengthy Regulations that are yet to be developed for implementation of the CPRS.

Use of subordinate legislation

In the past various Parliamentary Committees have held that regulations are appropriately used to include matters of detail and matters liable to frequent change. For the CPRS, a policy that will impact diverse organizations and consumers across the economy, it is sensible to consider utilizing subordinate legislation.

The essential theory of subordinate legislation is that:

- a) the Parliament deals directly with general principles;
- b) the executive or other body empowered to make subordinate legislation attends to matters of administration and detail.²

In this way, the Parliament can debate the broad principles contained in bills and still retain control over the detailed implementation of that policy by judicious use of its powers of disallowance.

But the main CPRS Bill, as it currently stands, gives little indication about the requirements for satisfying the EITE transitional arrangements provided in the CPRS to address competitiveness concerns. The details are left to be dealt with in regulation.

² Harry Evans (Ed), *Odgers’ Australian Senate Practice*, 12th edition 2008, p. 325.

In fact, of the 17 policy positions set out in the White Paper for EITE implementation 13 are to be covered in regulation and two do not appear to be covered by the Bill.

Given the import of the legislation this minimalist approach to setting out the details of how EITE will work is concerning. The minimalist approach also appears in many respects to be unnecessary as much of the material which is proposed to appear in the Regulations is described in the explanatory material (EM). There seems to be no reason why, if policy decisions on the issues outlined in the EM have already been reached, they cannot be set out in the CPRS Bill and subjected to debate in Parliament. It seems reasonable to suggest that if policy decisions are significant enough to appear in the EM then they are not mere matters of detail.

In addition, the proposed “objects” for the EITE arrangement section need to be defined more fully in black letter law:

- Object (a) is to enable identification of EITE activities. But the object should be to offset competitive disadvantage and provide adjustment assistance to Australian industry in the wake of the introduction of a price on carbon;
- Object (e) goes to the issue of whether foreign countries that are responsible for the substantial majority of the world’s emissions of carbon dioxide and other greenhouse gases have implemented sufficient measures to reduce those emissions. However, it is not necessarily these countries that are important to the competitiveness of Australian industry under the CPRS. Rather it is competition from overseas producers of Australia’s trade exposed products. In the case of coal major competitors that are not in the top ten emitters’ group include Colombia, Indonesia and South Africa. This point was made clear by the Garnaut Review and the Bill should establish it as one of its most important objects: and
- Object (f) covers “any other relevant matters” but is surprisingly vague and all encompassing as an object established at law by Parliament:
 - to give effect to government policy;
 - to ensure Parliament’s intent is clear; and
 - to inform the community and the judiciary of the objectives of the EITE scheme.This object should be removed.

Regulations are tabled in the Senate and the House of Representatives with the capacity to move/provide notice of motion within 15 sitting days of tabling that the regulations be disallowed. It is not possible for the Parliament to make any amendments. The importance of this issue would be diminished if the subordinate legislation, elements of which are going to be tabled in Parliament in stages, were broken down into a series of small packages which each dealt with discrete topics. Then the Senate could disallow a particular legislative instrument without having to disallow the entire package or part thereof (eg the EITE assistance program, for example).³ Given that the Regulations will include matters of the most fundamental significance – such as how many permits are to be allocated and at what level (60% and 90% are provided for in the explanatory material but are not open for review by the Parliament as part of the black letter law); the five year scheme caps and gateway; and emissions measurement,

³ It is noted that the Senate Standing Committee on Regulations and Ordinances would look to the government to clarify why multiple instruments are made at the same time on the same or similar matter.

reporting and auditing – the Regulation could only be disallowed at the potential cost of disrupting the entire CPRS.

These initial comments on the main CPRS Bill, including the extensiveness of the detail of the legislation that will be established at law under yet to be developed disallowable instruments, go to the heart of the ACA's concern with the legislation. As noted in a different context:

We are constantly told that Parliament should be concerned only with "broad principles" and should leave "details" to the journeymen. But what is principle and what is detail? "Broad principles" may be very attractive in theory, but may lose their charm if unworkable in practice, just as a grand strategic plan is valueless unless practicable in tactics. It is not good government to pass an Act first and think about it afterwards.

There are a good many examples of leaving to delegated legislation "sticky details" which are not really details at all but turn out to be matters of essential principle.⁴

Recommendation 1

To ensure Parliament can debate the broad principles contained in the CPRS bills and still retain control over the detailed implementation of that policy by judicious use of its powers of disallowance:

- The objects in Part 1 of the CPRS Bill should be expanded as proposed above to address the ACA's concerns;
- The objects in Part 8 concerning the EITE arrangements should also be amended as proposed above particularly to address concerns with objects (a), (e) and (f).
- The main Bill should be amended through incorporation of policy positions set out in the explanatory material to ensure an equitable and transparent approach to determining the allocation of permits to EITE activities. This approach also needs to be capable of being applied consistently over time as new activities begin operation in Australia and as other activities are covered by the Scheme.
- The subordinate legislation should be broken down into a series of small packages which each deal with discrete topics.

2. The establishment of the Emissions Intensive Trade Exposed (EITE) arrangements in the CPRS legislation

A fatal flaw in the White Paper approach is the way it assesses trade exposure. It does this by using emissions per unit of revenue to assess whether an activity is EITE or not. This is the wrong test as it is unrelated to trade exposed cost competitiveness and, in the case of resource industries such as coal, is distorted by commodity cycles.

Moreover, this approach does not fully offset the competitive disadvantage of trade-exposed businesses. Within the coverage of the proposed emissions trading scheme, and leaving aside agriculture, it is estimated that 45% of Australia's emissions are associated with potentially trade-exposed businesses. However, the White Paper position is that just 25% of permits will be sufficient to ensure no loss of competitiveness, investment and jobs from these businesses.

The ACA supports the Minerals Council of Australia concept of a graduated approach to auctioning. The ACA also supports the Australian Industry Greenhouse Network submissions to the Government on the Green and White Papers and to this Committee arguing that there should be an expansion of the trade exposure assistance package that is calibrated with international action to abate emissions and address human induced climate change.

⁴ Sir Carleton Kemp Allen, *Law and Orders An Inquiry into the Nature and Scope of Delegated Legislation and Executive Powers in English Law*, Third edition, 1965, p. 154.

As the Productivity Commission has pointed out: ⁵

- Independent action by Australia to substantially reduce GHG emissions, in itself, would deliver barely discernible climate benefits, but could be nationally very costly. Such action would therefore need to rest on other rationales.
 - Facilitating transition to an impending lower emissions economy is the strongest rationale for independent action, but it is contingent on the imminent emergence of an extensive international response.
- It is in Australia's interest to participate in the design of a multilateral framework — for example, pressing for:
 - emission caps for all major emitting countries that are supported by strong verification arrangements, and can react flexibly to new information;
 - allowance to gain credits for emission reduction projects in other countries and also flexibility in rules on land cover change.

Recommendation 2

The EITE transactional arrangements should be based on trade exposure, that is the extent to which an activity/facility can pass on the costs of emissions trading in international markets.

3. Unfair Exclusion of the coal industry from the EITE arrangements

The coal industry is eligible for 60% allocation of permits under the White Paper methodology yet the White Paper goes out of its way to exclude coal on the basis of:

- the wide diversity of emissions profiles across mines and therefore potential for windfall gains. However, as illustrated in the **Attachment** this issue can be addressed simply through a specific coal industry allocation rule that ensures permits are directed to mines in accordance with their fugitive emissions and avoids the potential for windfall gains to mines with low fugitive emissions. This allocation rule would also be designed so as not to reduce the incentive for miners to reduce their emissions in the future; and
- the potential for substantial step changes in emissions due to the availability of relatively low cost abatement technologies. This assertion is fundamentally incorrect. The Australian coal industry is a world leader in tackling emissions from the mining and use of coal and is implementing viable solutions. However the abatement technologies referenced in the White Paper have location-specific deployment limitations and require further technical development and demonstration.

The ACA submits that these claims do not provide sufficient or sound justification for excluding Australia's largest export industry from EITE status, particularly as the industry is eligible under the same rules the government has applied to all other activities.

Coal is one of the most trade exposed industries in the economy. This is well illustrated by the fact that Indonesia, the greatest volume beneficiary from the strong growth in demand for thermal coal in recent years, outstripped Australia to become the largest thermal coal exporter in 2005. In fact Australia has lost over 15% of its market share of seaborne thermal coal since 2002. In addition, falling global coal prices and rising permit prices would have a material impact on the competitiveness of the Australian coal industry. In the transition to a global price on carbon there is also considerable uncertainty regarding our major competitors such as South Africa, Indonesia and Colombia taking on any serious emissions targets in the next 10 to 15 years.

⁵ Productivity Commission *Submission to the Task Group on Emissions Trading*, March 2007, page VIII.

As a further illustration of Australia's competitiveness exposures, were China, which produces around 46% of world production, to switch even a portion of its coal to export markets again, which seems highly likely, this will further substantially impact world prices. In 2007 China exported some 53 million tons of coal, less than a government-approved quota of 70 million tons, because of increased domestic demand at the time.

The EITE arrangements have been developed to address these competitiveness issues so that EITE firms do not choose to leave Australia or reduce their investments here with no global environmental benefit. They also guarantee permit allocation for at least 10 years to ensure incentives remain for EITE firms to invest and adjust their emissions profiles consistent with an emerging global carbon constraint.

The proposal in the White Paper to establish a technology fund for coal industry emissions abatement (\$250 million matched by industry) and a transitional assistance scheme (\$500 million over five years) does not address the industry's international competitiveness exposure... These initiatives go some way towards recognising that the coal industry operates in a highly competitive global market and will be unable to pass on the bulk of CPRS costs. But the proposal does not adequately address the longer-term impact on future investment and jobs in Australian coal mines that will have to compete with overseas mines not facing similar costs.

The risks associated with the introduction of emissions trading have been greatly increased by the current global economic downturn and rapidly falling commodity prices. Substantial investment has been put on hold or cancelled, exploration activity significantly reduced, mines placed on care and maintenance and at least one being closed and some 3 000 direct jobs lost with flow on effects to regional economies and the broader community, including 9 000 indirect jobs being impacted, due to the economic multiplier effect coal production has.

The cumulative impacts on cost competitiveness due to the CPRS and the GFC are also on top of other regulatory impositions, including:

- increases in coal royalties in Queensland and NSW;
- the recent NSW mini budget decision to remove the allowable transport deductions for the purposes of royalty calculations;
- the imposition of a levy of \$15/tonne on coal washery rejects; and
- the increased regulatory burden particularly due to substantial duplication in regulation.

Recommendation 3

The design of the CPRS must deal effectively with the transition period in which there will be no comprehensive global agreement on emissions reduction or comparable emission trading arrangements elsewhere.

To ensure the competitiveness of the Australian coal mining industry and other trade exposed sectors:

- **the coal industry should be included in the trade exposed and emissions intensive arrangements as the best way to address the risks to its international competitiveness, coal jobs and regional prosperity. This would provide certainty and transparency for future investment in the industry and be equitable with the treatment of other activities;**
- **the CPRS should involve a gradual adjustment of the economy to reduce economic, transaction and compliance costs until a multilateral regime that comprises major emitting countries is in place.**

4. Energy security and the treatment of captured coal mines

The White Paper proposal does not provide a legislative solution to ensure CPRS cost pass through (under long-term contracts) or an allocation of permits, preferring to leave this to the market. In the case of captured coal mines supplying thermal coal for the domestic market, the prospect of mines being able to renegotiate long-term (eg 20 year) commercial contracts with power generators to pass on CPRS costs is considered unlikely.

While some contracts currently include “cost pass-through” clauses these were not designed with a potential emissions trading system in mind. Such contracts would only permit pass through of “taxes” or “charges”. As compliance with the CPRS is achieved by the purchase of permits, which can be purchased either from the Commonwealth at auction or in the marketplace, it will be difficult in the case of many contracts to show that the cost of acquiring permits is a “tax” or “charge”. By contrast most contracts would allow for the pass-through of a “carbon tax” as it is a tax. While the ACA supports the choice of an emissions trading scheme the use of an ETS does create a practical implication for miners which would not arise in the context of a carbon tax. In other words it is the structure of the system which causes the problem. In addition, the inability to pass through is at odds with the intent of the CPRS.

The current design of the CPRS will place significant financial stress on these mines, with consequent implications for asset owners and for Australia’s energy security.

Recommendation 4

The CPRS impact on captured coal mines to be largely addressed through incorporation of coal in the EITE arrangements.

On energy security grounds, permits should also be allocated to non-gassy captured coal mine owners where cost pass through is restricted or unavailable. Where pass through is available (fully or partially) then the generator would be compensated under the Electricity Sector Adjustment Scheme.

In responding to the Committee’s request for submissions, the ACA also notes the important role that technologies such as carbon capture and storage will play in achieving deep emission cuts while maintaining Australia’s energy security and economic growth objectives. The CPRS alone will not accelerate the deployment of these technologies and complementary measures to support investment in RD&D will be an essential part of a comprehensive and effective climate change response. The Australian black coal industry is investing \$1 billion in low emission coal technology demonstration and welcomes ongoing Government support for these technologies, including through the Global CCS Institute.

The ACA would welcome the opportunity to meet with the Committee to discuss these comments.

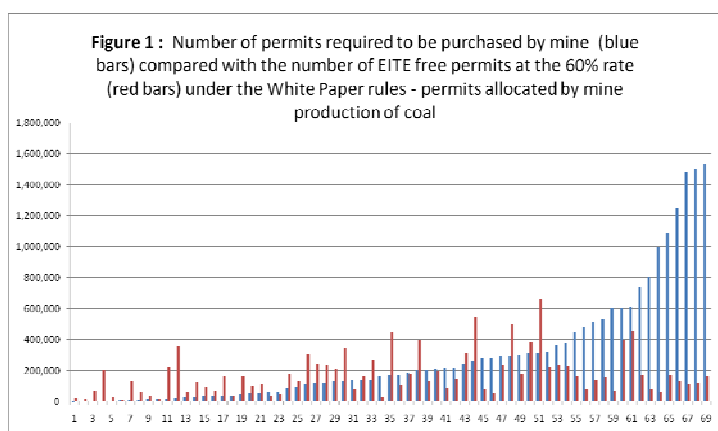
Yours sincerely



Ralph Hillman
Executive Director

ILLUSTRATION OF AN ALTERNATIVE PERMIT ALLOCATION RULE FOR THE AUSTRALIAN COAL MINING INDUSTRY DESIGNED TO PREVENT WINDFALL GAINS

The blue bars in **Figure 1** show the level of fugitive emissions for 69 underground and open cut coal mines in Australia in 2007 and illustrate the wide dispersion of fugitive emissions in coal mining. This wide dispersion by mine is unique to the coal and gold industries. Other activities only have a very limited dispersion of emissions by facility and so the allocation rule in the White Paper is appropriate for them.



If we employ the White Paper’s allocation methodology, which is based on the average emissions per tonne of coal production, then some mines would receive more permits (shown here in red) than they would have to purchase (the bars shown in blue). On the other hand the really gassy mines receive relatively fewer permits relative to the number they would have to buy.

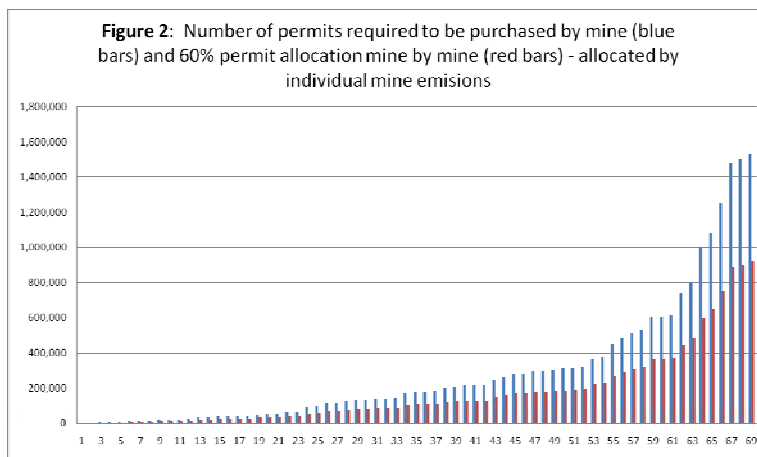


Figure 2 shows there is a simple solution to deal with the windfall gain issue. This involves allocation of permits mine-by-mine based on 60% of mine site direct emissions (the red bars). In this way all mines receive an allocation of permits in recognition of their trade exposure. Moreover, all mines, including non-gassy mines, still pay for 40% or any direct emission permits they require and are fully impacted by any cost escalation due to the implications of the emissions trading scheme for purchased inputs (ie the impact on the cost of transport, consumables, contractors, contract miners, etc).

The Government said this was not possible as you cannot have one rule for all activities except coal. But in fact this is precisely the approach adopted in the White Paper in allocating assistance to coal mines under the Coal Sector Adjustment Package.