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SENATE STANDING COMMITTEE ON ECONOMICS *INQUIRY INTO THE EXPOSURE DRAFTS OF THE LEGISLATION TO IMPLEMENT THE CARBON POLLUTION REDUCTION SCHEME*

APPEA Submission

MARCH 2009

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1. INTRODUCTION

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.

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 a submission to the Committee's *Inquiry into the exposure drafts of the legislation to implement the Carbon Pollution Reduction Scheme*.

At the outset, however, APPEA is concerned about the very tight timetable allowed for submissions (nine working days) and hearings (most held before submissions were due) into a package of Exposure Draft Bills and Commentary (the Package) that runs for over 700 pages.

To conduct an inquiry into *"... the most significant economic and structural reform undertaken in Australia since the trade liberalisation of the 1980s ... "*[1] over such a short timeframe does little to provide stakeholders with confidence that such an important reform is being undertaken in a considered and measured fashion. In addition, stakeholders are being asked to provide comments when the full package of legislative amendments and, very importantly, the regulatory framework, has not been developed.

As a result, APPEA is yet to complete its detailed review and consideration of the exposure draft legislation due to the limited time between the release of the draft legislation and the closing date for submissions. As a consequence, our comments on the exposure draft are preliminary.

APPEA is also a member of the Australian Industry Greenhouse Network (AIGN), a network of industry associations and individual businesses which 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

[1] Wong, Senator the Hon Penny, Minister for Climate Change and Water (2008), *Speech to the Australian Industry Group Luncheon Park Hyatt, Melbourne, Climate Change: A Responsibility Agenda*, 6 February (available at www.environment.gov.au/minister/wong/2008/pubs/tr20080206.pdf).

development[2]. 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. 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.

As part of its commitment to addressing greenhouse issues, APPEA was an original signatory to the Greenhouse Challenge Program in 1996[3]. 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_2-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 2003, of the industry's approach to greenhouse policy. A copy of the APPEA *Greenhouse Response Strategy* can be found at **Attachment 1**[4].

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

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[2] See www.aign.net.au for further information.

[3] 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) for further information.

[4] The *Greenhouse Response Strategy* can also be downloaded from the APPEA website, at www.appea.com.au/content/pdfs_docs_xls/PolicyIndustryIssues/APPEAGreenhouseResponseStrategyNov03.pdf.

> *… 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[5] 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.

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 Package. 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[6] provided by the Government, which 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

2.1 Treatment of emissions-intensive trade-exposed (EITE) activities (Division 8 of the draft *Carbon Pollution Reduction Scheme Bill 2009*): the role of 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 ETIE activities be included in the Act itself and not relegated to regulations.

[5] See 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 for a copy of the *Platform for Prosperity* report.
[6] 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).

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 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 Bill fail to achieve this outcome and requires 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 steps to clarify the impact of the proposed emissions trading scheme on Australia's liquefied natural gas (LNG) industry.

This means that provided it meets the criteria set out in the Commentary at paragraph 4.12 (and APPEA is currently working 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.

It remains the case, however, that the industry will be subject to a significant cost burden that is not borne by its LNG competitors[7] 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 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 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. 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) 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[8] and to the Senate Select Committee on Fuel and Energy[9] 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.

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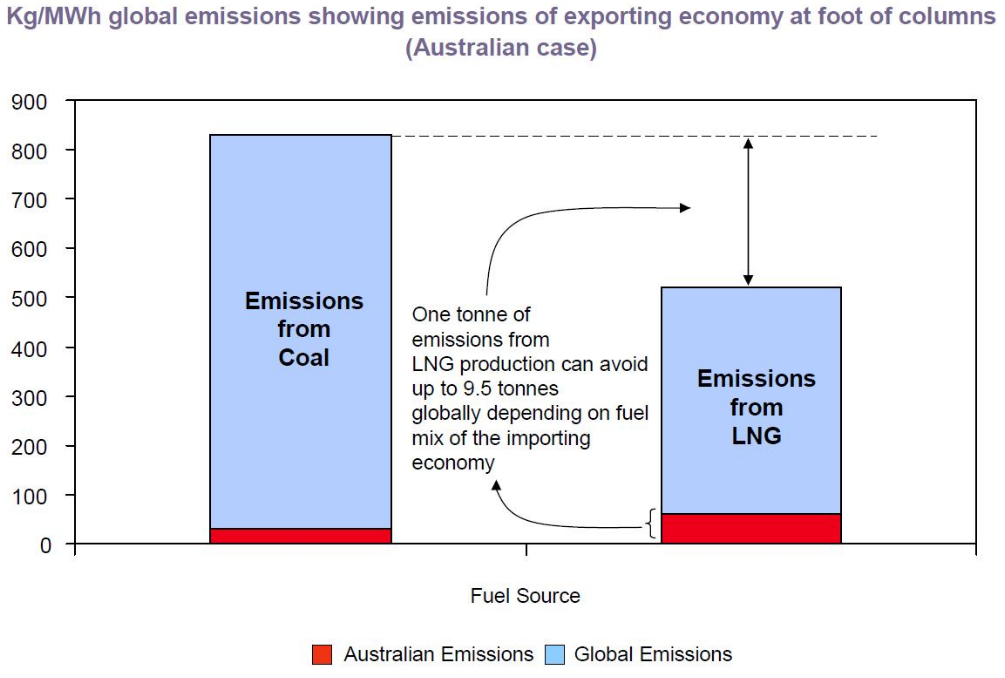
[7] Australia's LNG industry faces fierce global competition. Australia's major LNG competitors include Qatar, Algeria, Nigeria, Trinidad & Tobago, Egypt, Brunei, Indonesia, Malaysia, Oman and the United Arab Emirates.
[8] APPEA's submission to the Carbon Pollution Reduction Scheme Green Paper can be found at www.climatechange.gov.au/greenpaper/consultation/pubs/0834-appea.pdf.
[9] 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, www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/sub0018a.pdf and www.aph.gov.au/Senate/committee/fuelenergy_ctte/submissions/sub0018b.pdf.

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[10] in 1996, WorleyParsons[11] in 2008 and PACE[12] 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.

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.

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[10] CSIRO (1996), *Lifecycle emissions and energy analysis of LNG, oil and coal*, December.
[11] WorleyParsons (2008), *Greenhouse Gas Emissions Study of Australian LNG*, July.
[12] 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.

APPEA agrees with Professor Ross Garnaut[13] 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 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[14].

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, 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

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

[14] 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 an EITE 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.

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 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 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.

One of the possible ways to achieve this outcome advocated by APPEA as part of our response to the Green Paper, was the recognition of LNG and potentially other eligible activities, as a cleaner global contributor. APPEA proposed this be included within the emissions trading as a transitional measure to operate in the absence of an international carbon price on Australian LNG competitor and customer countries.

The proposed mechanism encompassed the following criteria to assess cleaner global contributor activities and therefore determine eligibility:

1. Global contributor: emissions reduced globally as a consequence of the product are more than the associated emissions produced in Australia;

2. Global sustainability: industry would expand under a global carbon price;

3. Affordability: economic benefit to Australia through additional taxation revenue associated with the industry's expansion would exceed the cost to Government; and

4. Trade exposed: capacity for passing through costs is restricted as a consequence of both competitor advantages and the substitutability of cheaper alternatives in the absence of a global carbon price.

A cleaner global contributor mechanism would offset international competitive disadvantage through the grant of permits representing the total of their direct and indirect emissions. Other measures of corresponding value could also be considered as a means for delivering a 'no net cost' outcome.

Further details of the cleaner global contributor mechanism can be found at **Attachment 2**.

In addition, analysis prepared for APPEA by Access Economics[15], shows that providing a 100 per cent permit allocation, through something like the cleaner global contributor mechanism, 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[16], 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.

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[15] Access Economics (2009), *Indicative costs and benefits of a LNG emissions costs offset*, January.
[16] 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").

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'.

As APPEA noted above, 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.

It follows that an appropriate international agreement that resulted in a comparable carbon cost facing Australia's LNG customers and competitors, would provide the solution to this issue. At that point, any EITE treatment is rendered unnecessary. With that in mind, the Australian LNG industry has played an active role – since the early 1990s – in international forums to advance such an outcome. These include:

- providing, through APPEA's membership of AIGN, representation at each of the fourteen Conference of the Parties (COP) meetings held under the United Nations Convention Framework on Climate Change (UNFCCC). With the exception of 2008, this has been as a member of the Australian delegation;

- participates in consultations, run by the Department of Climate Change, on the international negotiations and provides input, as appropriate, to the Australian Government's submissions to the UNFCCC[17];

- APPEA also participates directly in a range of climate change related international forums. For example, APPEA is a member of the Australian delegations to the Cleaner Fossil Energy Task Force of the Asia-Pacific Partnership on Clean Development and Climate (APP)[18] and to the Carbon Sequestration Leadership Forum (CSLF)[19]; and

- APPEA has participated in APEC Energy Working Group (EWG) considerations of international responses to climate change, including the December 2008 EWG meeting in Manila, The Philippines, that recommended cognisant of international efforts such as the UNFCCC, the EWG conduct a survey of member economies' climate change policies and approaches to reducing greenhouse gas emissions including carbon pricing. Subsequently, the EWG should convene a follow-up workshop to share information on such policies and approaches and to report on the potential role of agreements on the reduction of greenhouse gas emissions in the energy sector within APEC[20].

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.

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[17] See www.climatechange.gov.au/international/unfccc-submissions.html for more information.
[18] See www.asiapacificpartnership.org/tf_fossil_energy.aspx for further information.
[19] See www.cslforum.org for further information.
[20] See www.apec.org/apec/apec_groups/som_committee_on_economic/working_groups/energy.html for further information.

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 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.

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 it 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[21], that states:

> ***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 preliminary assessment, in the limited time available, suggests that the Division does achieve this, subject clarification of a number of matters. 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, South Korea and China) 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.

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

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 and 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.

2.6 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 acquittals rests with the individual joint venture participants in proportion with their interest in the joint venture.

2.7 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 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.

3. OTHER ISSUES

As noted above, a number of issues are not included with the Package 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 Package. 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 (post the submission and hearing dates for this inquiry);

- international linking provisions;

- 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; and

- the household assistance measures (for example, the legislative changes needed to give effect to the White Paper's policy position 17.2 (that the Government will initially reduce excise and excise-equivalent customs duty (fuel tax) on 1 July 2010 for all fuels currently subject to the general rate of 38.143 cents per litre).

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