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The Secretary
Senate Select Committee on Climate Policy
PO Box 6100
Parliament House
CANBERRA ACT 2600
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Dear Sir/Madam

Santos Submission to the Senate Select Committee on Climate Policy

Santos welcomes the opportunity to provide comment to the Senate Select Committee on the choice of emissions trading as the central policy to reduce Australia's Greenhouse Gas (GHG) emissions. In summary, Santos:

- supports the introduction of a well designed, market-based mechanism, such as a cap-and-trade emissions trading scheme (ETS) to underwrite the lowest-cost path to achieve GHG emission reductions;
- encourages the development of a "level playing field" energy policy response, one that refrains from "picking winners" and provides clear investment horizons to ensure the lowest-cost abatement to Australian industry, households and consumers; and
- believes Australia's abundant reserves of natural gas have the capacity to drive clean, affordable and reliable energy security to both Australia and the Asia-Pacific and in so doing materially contribute to both domestic and global GHG emission reduction efforts.

Company Profile

Santos is an Australian oil and gas exploration and production company with high quality assets and projects throughout Australia and the Asia-Pacific region. Santos has recently announced plans to enter into the gas-fired electricity generation market.

We supply over 20% of eastern Australia's domestic gas and have the largest Australian exploration portfolio by area of any company – 192,000 square kilometres.

Santos is developing a multi-billion-dollar project to build a liquefied natural gas (LNG) facility at Gladstone, Queensland – the world's first project to convert coal seam gas to LNG on a large scale. Santos is already a producer of LNG through our Darwin LNG joint venture, which has been exporting to Japan since 2006.

Santos has more than 1,700 Australian based employees working across its operations, and offices in Adelaide, Brisbane, Perth, Gladstone and Roma. The company has 170 staff in Jakarta, and country offices in Port Moresby, Hanoi, New Delhi and Bishkek.

Climate Change and Natural Gas

Australia is one of a handful of major industrial countries to possess abundant reserves of natural gas, and in close proximity to major domestic consumption centres and major Asia-Pacific import markets.

This provides a unique opportunity for Australia to position itself not just to deliver energy security in a carbon constrained environment, but to support the penetration of a clean energy source into the growing economies of the Asia-Pacific, such as China and India.

More specifically, in moving towards a lower emission economy, natural gas presents the following benefits for Australia in terms of providing one of the portfolios of practical solutions that will be necessary to ensure a clean, reliable and affordable energy mix into the future:

- It is a clean energy source, with gas-fired power generation emitting between 40 to 70% less GHG emissions than coal-fired power generation;
- Gas-fired power generation can reliably and affordably deliver today approximately 80% of the carbon emission reductions that retro-fitting an existing coal-fired power station with carbon capture and storage will deliver (at some unknown future time at some unknown future cost);
- It has a far lower water intensity, using a fraction of the water per mega watt hour as an existing coal-fired power station (up to one two hundredth in the case of Santos' proposed Shaw River Power Project in Victoria);
- Gas-fired power generation has a small footprint (15 hectares for 1,000 mega watts) and hence low community visibility and infrastructure requirements;
- Gas-fired power generation is an immediately available and reliable energy source, capable of producing peaking, intermediate and base load power generation;
- The flexibility of gas-fired power generation makes it a perfect partner for intermittent renewable energy sources in ensuring smooth supply side dynamics in, and the integrity of, the electricity sector;
- Australia's natural gas reserves are abundant (measurable in hundreds of years supply) and in close proximity to the major gas demand centres; and
- It is affordable, with gas-fired power generation competitive against both brown and black coal-fired power generation under a modest carbon price.

Furthermore, the Australian natural gas industry, both in western and eastern Australia, is experiencing strong employment growth, particularly around the coal seam gas sector. This actual and potential growth reflects the very large investments in proposed LNG projects and gas-fired power generation.

Santos notes that the World Wildlife Foundation identified replacing high-carbon coal with low-carbon natural gas as having significant short and medium term potential in avoiding locking in higher emissions from coal and buys time for the deployment of zero-emission technologies¹.

The Choice of Emissions Trading

Santos believes a well designed, market-based mechanism, such as a cap-and-trade ETS, as opposed to a carbon taxation system, is the lowest-cost path to the achievement of GHG emission reductions. In addition, an ETS can be linked globally to other trading schemes, such as the European Union scheme and the one now proposed by the new United States of America administration. In a speech to Congress in February 2009, President Obama urged the government to draft legislation for a cap-and-trade ETS².

This global integration of an ETS will ultimately give Australian businesses increased access to low-cost, cross-border abatement options as well as allow Australia to contribute to a global solution to climate change.

There is continued speculation that a carbon tax has the benefit of providing certainty around the price of carbon, albeit at the cost of a lack of certainty in the reduction of GHG emissions. However, because of the unknown GHG emission reduction outcomes resulting from a specific level of carbon tax, it is almost certain that the carbon tax will need to be adjusted over time, particularly over the 20 to 30 year life of most electricity generation assets. This means there will not be any significant certainty in the cost of carbon over the investment decision horizon, thereby negating the supposed benefit of a carbon tax.

It is important to realise that when making large investment decisions, such as the construction of a new gas-fired power station, energy producers will be faced with many uncertainties in the future cost of various key inputs such as fuel costs (e.g. the price of gas or water). There is also often significant uncertainty in the revenue earned on outputs due to fluctuations in the wholesale electricity price. The investment decisions are by necessity long-term and industries have developed numerous tools and skill-sets to manage these uncertainties. Santos does not believe that a carbon tax would provide any significant benefit to industry over a well designed cap-and-trade ETS.

Santos believes that a well designed, market-based ETS is best suited to manage the reduction of emissions across economic cycles, including the current global financial crisis. The proposed design of the government's Carbon Pollution Reduction Scheme (CPRS) ensures that the price of carbon is allowed to vary depending on the demand for permits.

¹ 2007 "Climate Solutions - Vision for 2050" Report, the World Wildlife Foundation (WWF).

² In the House, Henry Waxman (D-CA), the newly installed chairman of the Energy and Commerce Committee, and Ed Markey (D-MA), the chairman of the energy and environment subcommittee, unveiled a 648-page draft bill that includes a cap-and-trade mechanism.

It is well known that as economic activity falls then emission levels generally decrease. At these times the demand for permits in a market-based scheme would be reduced and the price of permits would fall as a consequence. This is an extremely valuable feature of a market-based scheme as it provides relief to businesses and consumers during economic downturns.

This is precisely what has been seen in the pricing of permits in the European Union scheme over the last six months. It is ironic that some of the proponents of a carbon tax see this result as being detrimental. Santos believes exactly the converse, this is a very valuable, self-regulating feature of a market-based scheme.

The best long-term incentive for GHG emission reductions through low-emission technology is a well designed, market-based scheme, not one dependent on governments periodically resetting taxation levels from time to time. A market-based scheme is best suited to manage emissions through the various economic cycles in an efficient manner.

Santos believes that a fundamental feature of a well designed, market-based ETS is the ability of the cost of carbon to flow through in the price to the end user of a product or service. In the case of the proposed CPRS, the government has recognised that there are two main constraints on businesses' ability to pass-through carbon costs³:

- "it is likely to be more difficult and expensive for Australia as a whole to meet any particular emissions target if price signals that guide production, investment and consumption decisions to reduce emissions are blocked, and prices do not reflect reasonable carbon costs; and
- regulatory or contractual impediments to carbon cost pass-through may increase the impact of the Scheme on particular firms or industries".

To counteract any contractual impediments to carbon cost pass-through, Santos strongly believes that a statutory pass-through provision, acting for a transitional period, needs to be inserted into the CPRS Bill to reinforce the key design of the CPRS that the carbon price signal is passed through to the end users.

In the case of emissions intensive trade exposed (EITE) industries, such as LNG, in the absence of an appropriate global carbon agreement, it is unlikely that the cost of carbon will flow through in the price to the end user of a product or service. Therefore, Santos strongly believes that the EITE assistance as proposed in the CPRS is a fundamental feature of a well designed, market-based ETS. In "The Garnaut Climate Change Review: Final Report", Professor Garnaut stressed the importance of EITE assistance as critical to future investment decisions in the resource export sector. However, Santos notes that the proposed CPRS Bill leaves the crucial details of the EITE assistance to future Regulations. Santos would like to stress the importance of significant and robust engagement with major stakeholders in the development of the EITE Regulations to ensure Australia's competitiveness in the resource export sector.

³ Australian Government, "Carbon Pollution Reduction Scheme Australia's Low Pollution Future", White Paper December 2008, Section 15.3.

Complimentary Measures

Santos strongly believes that a cost of carbon set by the market will automatically drive businesses towards the lowest-cost abatement solution. Any further overt intervention risks reducing the efficiency of the market-based mechanism.

Much has already been written by various organisations on the cost of the Mandatory Renewable Energy Target (RET). Treasury modelling⁴ shows, the RET achieves potential emission savings at around three times the cost of an ETS. Indeed every independent assessment of the RET, including those undertaken by the Productivity Commission, Professor Garnaut and the Treasury has come to the same conclusion. Although the RET undoubtedly encourages the introduction of renewable technologies, it does so at a high cost compared to the simple introduction of a carbon cost via a cap-and-trade ETS.

It is important to realise that one of the key objectives of climate change policy is the reduction of GHG emissions *not* the introduction and development of any particular technology. In Santos' view the government should refrain from "picking winners" such as renewable or so-called clean coal technologies. A well designed, market-based scheme with a robust emissions cap will ensure the least-cost abatement solution is realised. In that regard Santos favours the phasing out of the RET scheme as quickly as possible together with other assistance schemes that preferentially target specific technologies.

By contrast a cap-and-trade ETS will naturally see the cost of carbon rise as the emission reduction targets progressively increase. As this occurs gradually more costly technologies will become economic. However, significantly, the lowest-cost technologies will be introduced first, thereby ensuring at all times the least-cost solution is achieved.

We would be pleased to discuss any matter raised in Santos' Submission at your convenience.

Yours sincerely

CHRISTIAN D. BENNETT

Group Executive Public Affairs

⁴ Commonwealth of Australia, Australia's Low Pollution Future, October 2008.