



# Submission to the Carbon Pollution Reduction Scheme Green Paper

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## **EXECUTIVE SUMMARY**

Chevron Australia (Chevron) welcomes the opportunity to submit a response to the Carbon Pollution Reduction Scheme (CPRS) Green Paper. Chevron supports a climate change policy approach that is transparent, encourages global emission management, promotes energy security, maximizes energy efficiency and conservation, is measured and flexible, has broad equitable treatment, and enables technology. Chevron acknowledges that the Green Paper is intended to facilitate discussion on many issues rather than communicate a firm policy position. Chevron looks forward to continuing participation in this important policy dialogue with the Australian Federal Government.

Global energy demand is forecast to increase by 50% between 2005 and 2030 with the most rapid growth in demand projected for nations outside the Organization for Economic Cooperation and Development (OECD).

In developing an environmentally efficient climate change policy the gross level of emissions within a particular jurisdiction is irrelevant -- what is important is a global reduction in emissions. In the context of developing Australia's climate change policy, consideration needs to be given not just to Australia's emissions, but also to the contribution Australia can make to reducing emissions in other jurisdictions. The benefit of the Australian liquefied natural gas (LNG) industry in lowering emissions in other countries underscores this point.

Increasing the supply of LNG into this growing global energy market has the potential to assist economies to manage their greenhouse gas emissions. The use of LNG for primary energy results in about half the life cycle greenhouse gas emissions compared to other fuels such as coal. Policies that work to facilitate the increased penetration of LNG into these markets should be a priority for governments concerned about the risks posed by climate change.

Australia has the recognised potential to become a major supplier of LNG to Pacific Basin markets, however, over the last twenty years it has only delivered on a relatively small percentage of this potential. This is a reflection of the technical and engineering challenges faced by emerging LNG projects and the modest returns of LNG projects, given the high levels of capital investment and long lead times prior to achieving positive cash flow.

There are elements of the design – including banking, acquittal points for domestic gas and greenhouse gas storage, monitoring and assurance provisions as well as international linkages – which Chevron views as key aspects for the development of a workable emission management scheme. Nonetheless, Chevron is unable to support the Government's preferred design options for the CPRS as put forward in the Green Paper. Implementation of the Green Paper will result in a significant additional cost burden being imposed on existing and proposed LNG projects within Australia not borne by our international competitors.

Each of the two LNG projects that Chevron is proposing to construct in Australia would be faced with roughly a doubling in operating costs (assuming a permit price of \$50 per tonne, with a flat trajectory) or an additional \$250-300 million in annual costs – costs which cannot be passed on to foreign customers. This is anticipated to have a significant impact on project economics. It is also a direct consequence of the model proposed in the Green Paper, which fails to adequately address LNG as a trade exposed industry.

Chevron's specific concerns with the proposed scheme design center on:

- The provision of assistance to only trade exposed firms that are "most materially affected";
- The use of revenue to determine which industries should be treated as trade exposed;
- Limiting the degree to which assistance is to be provided to non-agriculture trade exposed industries to 20% of the permits available under the scheme cap; and
- The ability for the scheme to accommodate new trade exposed entrants without undermining the competitiveness of established operations.

Without further consideration of these fundamental issues, the implementation of a CPRS will hold back the development of Australia's LNG industry. The outcome of this will be either that the growing energy demand in the Asia Pacific basin will be satisfied by other international LNG projects, resulting in a loss of economic activity for Australia, or that this demand is satisfied by the increased use of coal, resulting in higher levels of global greenhouse gas emissions.

The Government needs to recognize that LNG is an asset of regional importance in terms of greenhouse gas reduction efforts. Government should, therefore, be mindful that carbon reduction schemes should support and encourage the development of LNG projects and not disadvantage them. This submission urges the Government to recognize LNG as a trade exposed industry and to ensure that the development of LNG resources is not hampered by the CPRS.

## **SECTION 1: Introduction and General Comments**

### ***About Chevron***

Chevron Corporation, through its subsidiaries and affiliates, operates across the entire energy supply spectrum as a global energy supplier. Chevron's interests include exploring for, producing and transporting crude oil and natural gas, refining, marketing and distributing petroleum fuels and other energy products, generating electrical power, designing and marketing large-scale energy efficiency solutions; and commercialising the energy resources of the future, including bio-fuels and other renewable energy. Chevron is the world's largest producer of geothermal electricity and maintains one of the largest hydrogen transportation fuel infrastructures in the United States of America. Chevron Corporation employees approximately 54000 people and its subsidiaries conduct business in over 100 countries. Chevron Corporation is based in San Ramon, California.

In Australia, Chevron is the largest holder of Australia's natural gas resources with our primary interests comprising a one sixth interest in the North West Shelf project, the sole proponent of the Wheatstone LNG Project, an interest in the Browse LNG Project and 50% equity owner and operator of the Greater Gorgon Area natural gas resource.

The Greater Gorgon gas resource comprises approximately 25% of all the natural gas discovered to date within Australia. Chevron and its joint venture partners, ExxonMobil and Shell, are working toward commercialising this gas resource by establishing a major LNG processing centre on Barrow Island, approximately 60 km off the North West coast of Australia. Ongoing efforts to reduce greenhouse gas emissions from this proposed project have resulted in a reduction in emissions intensity such that the proposed project will be one of the worlds most greenhouse gas efficient sources of LNG. A significant contributor to achieving this world class emission intensity reduction is the proposal to geologically store naturally occurring carbon dioxide contained in the reservoir gas which would otherwise be vented to the atmosphere. This "beyond no regrets" commitment, which is projected to cost at least \$1 billion, is a clear demonstration of Chevron's, and its partners, commitment to tackling greenhouse gas emissions.

Chevron supports flexible and economically sound policies and mechanisms that protect the environment as part of its action plan to reduce greenhouse gas emissions from its business operations. We support a climate change policy approach that is transparent, encourages global emission management, promotes energy security, maximizes energy efficiency and conservation, is measured and flexible, has broad equitable treatment, and enables technology.

### ***The Carbon Pollution Reduction Scheme Green Paper***

Chevron Australia (Chevron) welcomes the opportunity to submit comments in response to the Carbon Pollution Reduction Scheme (CPRS) Green Paper. Chevron acknowledges that the Green Paper is intended to facilitate discussion on many issues as opposed to communicating a firm policy position. Chevron looks forward to continuing opportunities to participate in this important policy discussion.

Chevron notes that the analysis of the policy options contained in the Green Paper is undertaken in the absence of a clear indication by Government of its proposed emissions reduction trajectory and the resulting indicative emissions price. Clearly it would have been preferable for industry to have considered the

proposed policy options in the context of a proposed emissions reduction trajectory.

Chevron is unable to support the Government's preferred design options for the CPRS as put forward in the Green Paper. The model for dealing with trade exposed industry in the Green Paper would expose Australia's LNG industry to a significant increase in costs, eroding the industry's ability to compete fairly on international markets. It fails to deliver on the Government's commitment in its resource policy to "ensure that Australia's international competitiveness is not compromised by Australia's response to climate change" and "ensure that Australian operations of trade exposed firms are not disadvantaged by emissions trading"<sup>1</sup>.

The Government is faced with a choice going forward. It can design an emissions trading scheme that addresses Australia's greenhouse gas emissions and encourages the further development of Australian LNG industry rather than one which places restraints on the development of this important industry. A scheme that restrains the LNG industry will not only impact Australia's economic prosperity, but also potentially result in a marked increase in global greenhouse gas emissions. The choice for Government is clear and Chevron urges the Government to recognize LNG as a trade exposed industry and to ensure that the development of LNG resources is not hampered by the CPRS.

Chevron understands and appreciates the difficulty in balancing the desire for Australia to take action to reduce emissions in advance of our trade competitors while maintaining the international competitiveness of Australia's trade exposed industries. This is a complex policy consideration and should receive detailed and exhaustive consideration prior to the finalization of any position by Government. It is critically important that Australia's trade exposed industries are fully consulted during this process and the impacts on these industries acknowledged and understood prior to any position being finalized by government. Understanding the financial impacts of imposing additional cost on these industries is critical in determining how these industries should be treated. In this context it appears unlikely that an economically responsible policy consideration can be undertaken, legislation implemented, a regulator established and time allowed for Government and industry to prepare for implementation by mid 2010.

## ***Natural Gas and Global Greenhouse Gas Emissions***

The United States Energy Information Administration forecasts global energy demand increase by 50% between 2005 and 2030 with the most rapid growth in energy demand projected for nations outside the Organization for Economic Cooperation and Development (OECD). Non-OECD economies in the Asia region account for much of this increase in demand with primary energy consumption forecast to grow from 115 exajoules in 2005 to 251 exajoules by 2030<sup>2</sup>.

Natural gas is widely recognized as having around half the life cycle greenhouse gas emissions and reduced emissions of sulphur dioxide and particulates compared to other base load fuels such as coal. Natural gas represents the least greenhouse intensive fuel for base load power generation short of adopting nuclear power. As such, the increased use of natural gas both within Australia and internationally has an important role to play in the drive to reduce the growth in global emissions particularly in the short to intermediate term.

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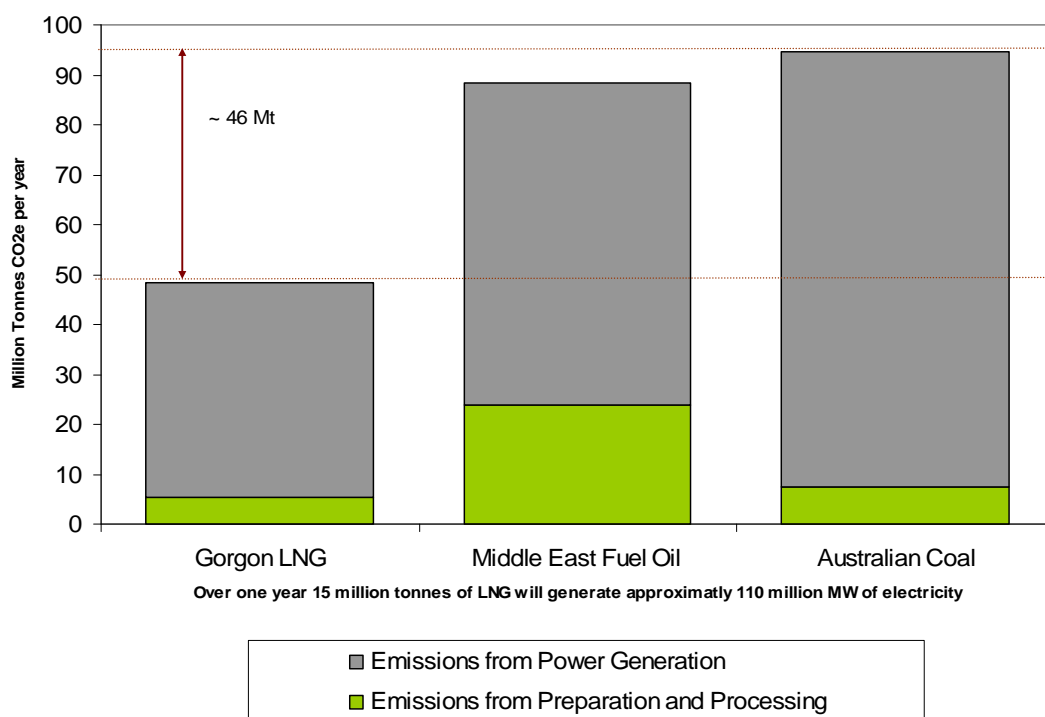
<sup>1</sup> Labor's Plan for a Stronger Resource Sector – Labour's Energy and Resources Policy, launched November 22, 2007.

<sup>2</sup> Energy Information Administration, International energy Outlook 2008, Available from <http://www.eia.doe.gov/oiaf/ieo/emissions.html>

By way of illustration, the Gorgon Project is planned to produce approximately 15 million tonnes of LNG per year for export to Pacific Basin markets which will result in an additional 5.2 million tonnes of greenhouse gas emissions per year in Australia. The life cycle greenhouse gas emissions associated with the energy produced from the Gorgon Project (that is the emissions within Australia resulting from the production of the LNG and the emissions from the transportation and burning of the gas by the end use consumers, for example in Japan and China) will amount to approximately 49 million tonnes per year. This compares to approximately 95 million tonnes of greenhouse gases per year if that energy demand was met from Australian or internationally sourced coal. The use of LNG from the Gorgon Project to provide energy in Pacific Basin markets will result in 46 million tonnes less greenhouse gas emissions per year compared to a scenario where coal had been used to meet that energy demand. The emissions benefit from one Australian LNG project, therefore, has the potential impact on global greenhouse gas emissions equivalent to removing two thirds of all the vehicles from Australia's roads.

The use of natural gas also results in significantly reduced emissions of sulphur dioxide and particulates compared to the use of coal. The increased use of natural gas provides a practical opportunity to assist countries like China reduce not only their greenhouse gas emissions, but atmospheric pollutants as well.

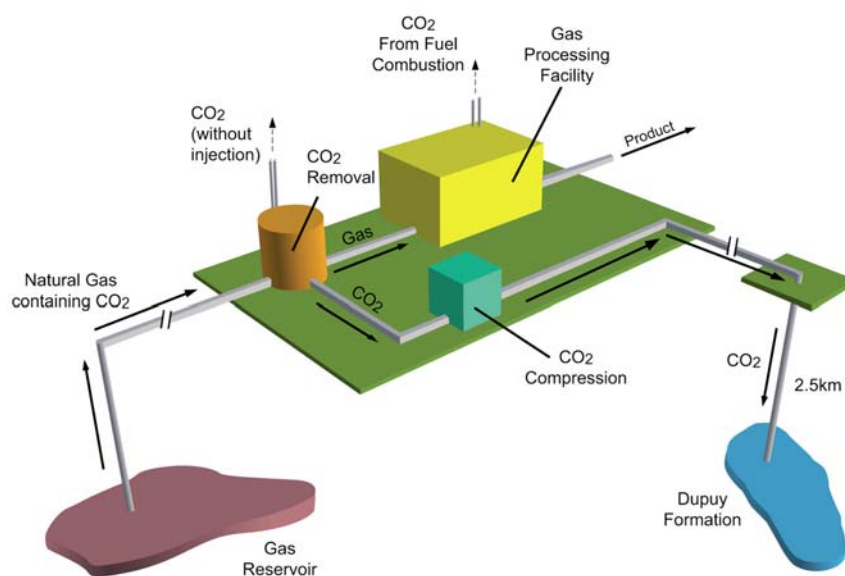
**Figure 1: Life Cycle Emissions Comparison<sup>3</sup>**



<sup>3</sup> Figure 1 shows a comparison of life cycle greenhouse gas emissions for the Gorgon Project compared to competing fuels in the Asian market. This data is based upon an analysis conducted for the Gorgon Joint Venture by the Commonwealth Scientific Research Organization. The green sections of the bar graphs represent the greenhouse gas emissions associated with the production of the energy, whereas the grey parts of the bar graph reflect the greenhouse gas emission where that energy is consumed.

In addition to the compelling environmental benefits of using LNG to meet growing global energy demand, the LNG industry is also at the forefront of the commercial scale application of greenhouse gas storage technology. The Gorgon Project will position Australia as a world leader in the application of this technology with injection rates between three and four times greater than applied by the existing commercial scale projects. This action is anticipated to reduce the overall level of project emission by approximately 40 percent or 3.7 million tonnes of carbon dioxide per year.

**Figure 2: Gorgon Project – Carbon Dioxide Injection System**



Chevron is aware of other Australian LNG projects that are also looking at the application of this important technology. It can be expected that as these projects address the legal, policy and regulatory issues, and build community confidence in greenhouse gas storage, they will clear the way for implementation by a wider range of industries. As an example, the Gorgon carbon dioxide injection project has already established a number of world firsts, including the world's first commercial scale greenhouse gas storage project to undergo an environmental impact assessment including public review and comment.

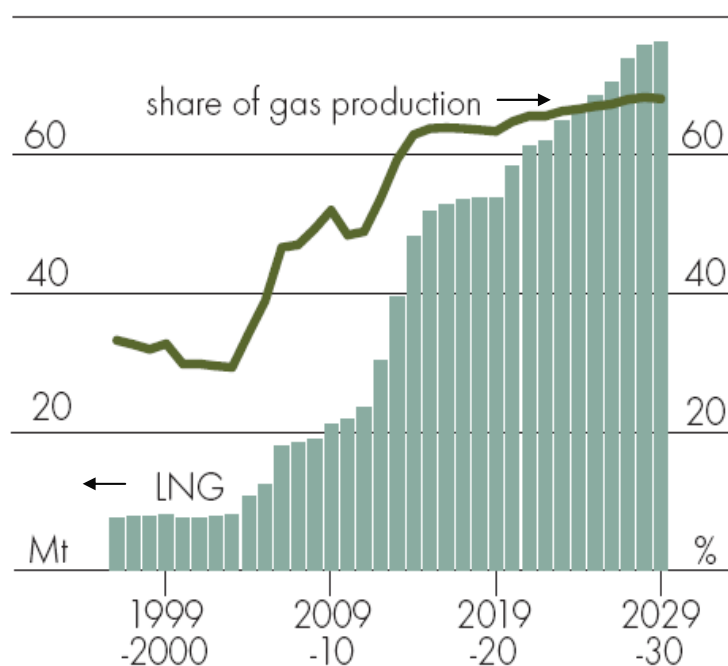
In addition the Gorgon Joint Venturers have committed to the public disclosure of monitoring data from the Gorgon Carbon Dioxide Injection Project to assist in the further development of this important technology. This will facilitate technology transfer from Australia to other countries enabling them to better reduce their own greenhouse gas emissions. The implementation of such a large scale carbon storage project by itself demonstrates Australia's world leadership with respect to climate change action.

Any negative impact on the future development of Australia's LNG industry is likely to also hold back on the commercial scale deployment of this technology. This will, in turn, constrain the ability of other sectors in the Australian economy to significantly reduce their emissions.

## ***The Realities Facing the Australian LNG Industry***

The Australian Bureau of Agriculture and Resource Economics (ABARE) estimates that Australia has the potential to grow its LNG exports from the current level of around 15 million tonnes per year to 76 million tonnes per year by 2030. Figure 3 shows ABARE's forecast growth in Australian LNG exports up to 2030. This graph also shows the percentage of Australian gas production being directed to international exports as LNG.

**Figure 3: Forecast Growth In Australian LNG Exports<sup>4</sup>**



Australia currently supplies approximately 7% of the LNG traded globally and competes primarily with producers in the Middle East, Indonesia, Malaysia and Brunei for supply into the existing and emerging markets of Japan, Korea, Taiwan, India and China. It is worthwhile noting that the countries with which Australia competes to supply LNG have, to date, not shown any inclination to impose emissions constraints on their industries; thus additional costs placed upon the Australian LNG industry as the result of an emissions reduction scheme cannot be passed on to its foreign customers.

<sup>4</sup> Source: ABARE Energy Projections To 2029-30 Research Report 07.24.

The vertical bars (left axis) show the potential growth in Australian LNG exports in millions of tonnes per year. The line graph (right axis) shows the annual percentage of Australia's total natural gas production potentially exported as LNG.



developing Australia's LNG potential is a signal that investors view the risk/return relationship in Australia as marginal.

Without a competitive investment environment the development of these gas resources may be delayed or remain undeveloped and the resulting energy demand will be met from other regions which do not have commitments to reduce greenhouse gases (i.e. the Middle East) or competing fuels such as coal. This will negatively impact investment in exploration activities as well.

### ***The Economic Impact LNG Projects on the Australian Economy***

The development of Australia's remote gas resources provides economic benefits commensurate with the scale of these projects. An Economic Impact Assessment recently undertaken by ACIL Tasman for the Gorgon Project shows that based on the first 30 years operation of a 15 million tonne per year, three train development, we expect:

- The net present value of Australia's GDP to be boosted by \$65 billion;
- Deliver PRRT payments to Government of \$19.2 billion over the life of the project and total government revenue of \$39.8 billion;
- Deliver \$33 billion flowing to Australian industry over the life of project (30 years);
- Deliver a 3.9% increase in Western Australia's 2020 Gross State Product;
- Peak construction employment in Western Australia of around 6,000 with more than 3,500 direct and indirect jobs sustained throughout the life of the project;
- Aid the development of world-leading technologies such as greenhouse gas storage.

The Chevron operated Wheatstone LNG project will provide similar economic benefits to Australia.

In addition to the direct economic benefits attributable to Australian LNG projects there are additional intangible benefits such as increasing the diversity of domestic natural gas supplies. This is an issue of particular importance in Western Australia. While small gas fields close to existing infrastructure can be economically developed, the relative small size of the domestic market prevents an economic return on the large capital investments required to develop many remote gas fields. The only way these fields can be commercialised is by large scale developments underwritten by LNG. However, once developed to supply LNG, the incremental economics required to supply gas to the domestic market is improved.

### ***Costs to LNG Industry***

In order to understand the potential impacts on the LNG industry, and to highlight the significant potential costs to the Australian LNG industry posed by the Green Paper, Chevron has joined with a number of other LNG industry proponents to commission an independent economic analysis of the impacts of the proposed CPRS on a range of hypothetical new LNG projects<sup>5</sup>. This analysis assumes that the LNG industry is not eligible for treatment as a trade exposed industry as is currently proposed in the Green Paper.

To illustrate the cost of the proposed emissions trading scheme over the life of an LNG project, an hypothesized emissions price at 2010 of \$20 per tonne of CO<sub>2</sub>e

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<sup>5</sup> Report was prepared by ACIL Tasman.

in today's dollars, ramping linearly thereafter by \$2 per tonne per year. The net present cost faced by these projects to purchased emission credits ranges from \$783 million to \$2.8 billion. The impact of these costs may constrain LNG investment in Australia.

## **SECTION 2: Assistance To Trade Exposed Industries**

As identified in the opening remarks in this submission, Chevron is unable to support the proposed design of the CPRS as put forward in the Green Paper primarily because it fails to adequately address the competitive challenges faced by Australia's trade exposed industry in the absence of a global emissions reduction framework.

Chevron believes there is a compelling argument that expanding Australia's supply of LNG into Pacific Basin markets has a role to play in addressing greenhouse gas emissions in those markets. In addition, the LNG industry will be at the forefront of the commercial scale demonstration of greenhouse gas storage technologies in Australia, addressing the many legal, regulatory and policy issues and building public confidence in these technologies ahead of its application by other industry sectors. Despite this, the model as proposed in the Green Paper results in a significant additional cost burden being placed on the LNG industry that is not born by Australia's LNG supply competitors.

Government has a clear decision to make in determining how the LNG industry will be treated under the CPRS. It can either hold back the development of the industry with its commensurate likely impact on global greenhouse gas emissions and the rate of low emissions technology deployment in Australia, or it can implement design features that support and encourage the development of Australia's LNG industry.

If the preferred design options contained in the Green Paper are implemented, the introduction of the CPRS can only hinder the further development of the Australian LNG industry.

### ***Rationale For Trade Exposed Industry Assistance***

The Green Paper correctly states that "Changes in the cost structures of entities and industries are not unusual and occur continuously in a market-based economy; nor is it unusual for Government policy to change cost structures". The issue for trade exposed industry arises in this case given the magnitude of the additional cost impost that may potentially be placed on some industries. As indicated earlier in this submission, the impact of the CPRS on the projects Chevron is developing has the potential impact of doubling annual operating cost.

The Green Paper identifies the avoidance of "emissions leakage" as the principle consideration in determining how best to deal with trade exposed industry. Chevron believes that leakage is a symptom of a broader issue of a failure to attract investment capital to Australia. Without a continued flow of investment capital, Australian industrial activity will decline. The result of this is that Australian emissions are reduced but at the expense of increased emissions in other economies.

<p>In considering how best to treat Australia's trade exposed industry, the policy objective should be to create an environment that is conducive to continuing investment in trade exposed sectors. Success in maintaining investment in these sectors will ensure emissions leakage is minimized.</p>
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The Green Paper asserts that permit allocation to trade exposed industries increases the economic cost of the CPRS and shifts the burden of emissions reduction costs to households and other sectors of the economy. Chevron does not concur with this assertion. Correctly designed, permit allocation to trade

exposed industry does not inhibit the pursuit by those industries of emissions abatement opportunities at a cost below the prevailing market price for permits. Consequently no extra abatement needs to be undertaken by other sectors of the economy, including households.

The Green Paper identifies the following rationale for providing assistance to trade exposed industries:

- To address some of the competitive impacts of the scheme in order to address carbon leakage;
- Provide transitional support to industries that will be most severely affected by the introduction of the scheme; and
- Support production and investment decisions that would be consistent with a global carbon constraint.

Chevron maintains that these rationale are inconsistent with the policy positions put forward previously by the Government.

Government should reassess its rationale for providing transitional assistance for trade exposed industry. Rationale should center on the Government's commitments to "ensure that Australia's international competitiveness is not compromised by Australia's response to climate change" and "ensure that Australian operations of trade exposed firms are not disadvantaged by emissions trading".

## ***Form of Assistance***

In developing the preferred form of assistance for trade exposed industry, Government has identified the allocation of emission permits in preference to exemption from the scheme, border adjustments based on embedded emissions of traded goods, or cash payments directly to trade exposed industry. Chevron notes that this position builds upon the previous emissions trading proposals developed over the last two years

Chevron concurs with the position taken in the Green Paper that exemption of trade exposed industry from scheme coverage is not desired despite it being relatively simple to administer. Exempting some industries either places an increased burden on other sectors or exposes the non-covered industry to alternative prescriptive policy measures that are less efficient than applying a price signal via an emissions trading scheme.

The use of robust border adjustments would preserve the trade competitiveness of trade exposed industries but as government has identified is difficult to apply as a consequence of having to determine the embedded emissions of all exports and imports.

Assistance to trade exposed firms, by either an administrative allocation of emissions permits or by cash grants, has the potential to preserve the competitiveness of trade exposed firms but only to the degree to which permits or cash are provided. The allocation of emissions permits has the added advantage of accommodating any change in permit prices between permit allocation and acquittal. Importantly, the provision of assistance does not change the economic incentive to reduce emissions. This is determined by the prevailing emission price and the firm's marginal cost of abatement.

The assistance given should be linked to the level of production from a facility so as not to provide incentives to reduce production nor to restrain an increase in production.

Chevron supports the proposal to provide assistance to trade exposed industries in the form of an administrative allocation of emissions permits at the beginning of each compliance period, contingent on levels of production.

### ***Identifying Recipients of Trade Exposed Industry Assistance***

Chevron is concerned that the overall approach to determining assistance to trade exposed industry appears focused upon identifying those industries that will carry a greatly increased additional cost rather than honoring the Government's stated commitment to avoid compromising Australia's international competitiveness and disadvantaging Australia's trade exposed firms.

Chevron recommends Government reconsider the basis by which it views which firms are trade exposed from one where only a limited number of highly impacted industries receive treatment to one where trade exposed industries that incur more than a small increase of costs as a result of the introduction of the CPRS would receive treatment as trade exposed.

The use of Australian and New Zealand Standard Industry Classifications to define which industries should receive treatment as trade exposed is problematic for Australia's LNG industry as this industry is currently not recognised as a category in these classifications. Accordingly, determining assistance at an industry level based on these classifications is not supported by Chevron given the distortions this could cause for the Australian LNG industry.

If the model proposed in the Green Paper for dealing with trade competitiveness issues across the Australian economy is adopted as Government Policy, Chevron is generally supportive of the approach of providing assistance on the basis of industry wide emissions from a process or at an activity level.

We note that in defining the level of an "activity", the example provided in the Green Paper of the aluminum industry involves a traded commodity between each of the proposed activities. Bauxite, alumina, aluminum ingots and semi fabricated aluminum are all traded on international markets. Another way of considering these activities is that each step in the process of producing aluminum can operate independent of the next step.

Figure 5 shows a general process flow for a typical LNG Project. Most projects consist of two principle components: a gas production system and the LNG processing plant. Importantly, however, neither component can exist without the other. It is not physically possible to have an LNG plant without its gas supply infrastructure.

Within each of these components there exist a number of sub components. In addition to the production of LNG many LNG projects also have facilities that provide domestic gas, condensate and potentially liquefied petroleum gases (LPG)<sup>6</sup>.

The principle source of greenhouse gas emissions from the LNG process are highlighted in yellow in Figure 5. The level of emissions from each of these sources varies greatly between LNG projects due to a range of environmental factors such as gas quality, ambient operating conditions and distance between

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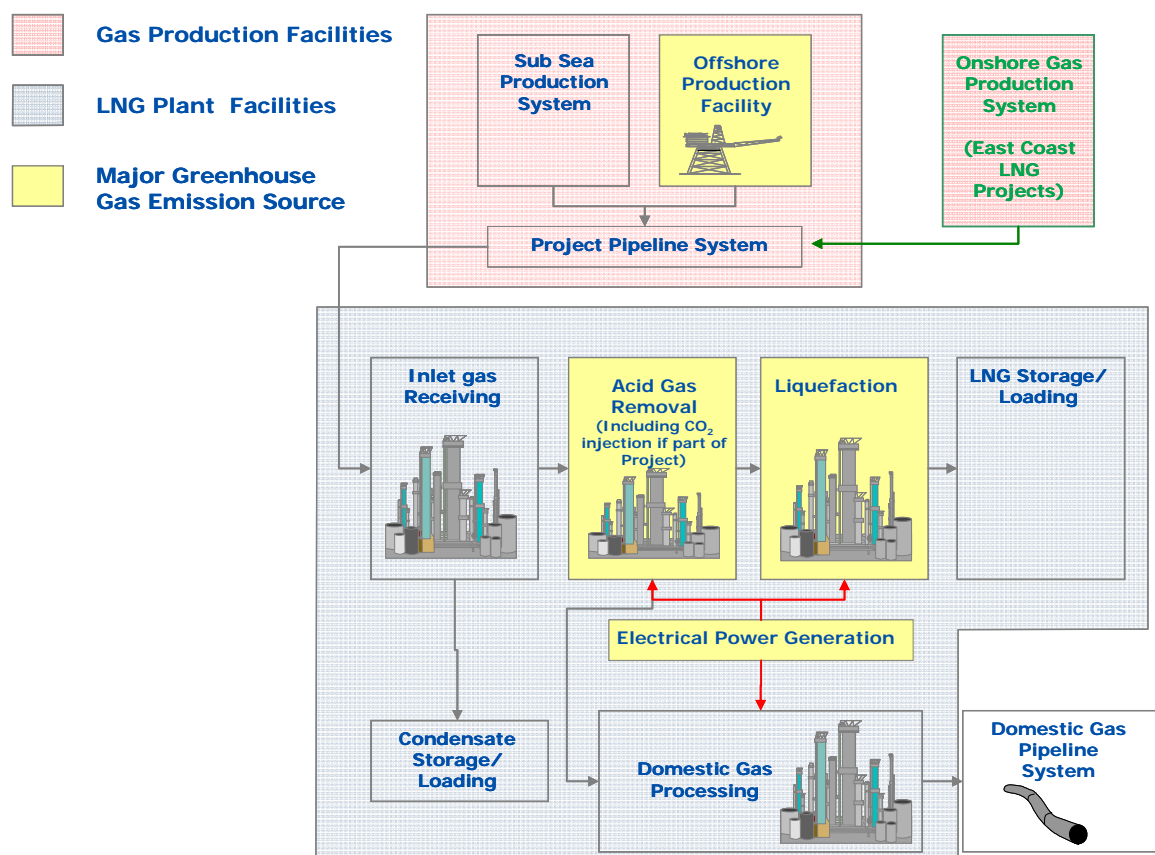
<sup>6</sup> LPG is not shown on these figures.

the gas fields and the LNG processing facilities. Minor differences may also occur due to differences in process design and technology selection<sup>7</sup>.

Unlike the example of the production of aluminum, no single component, or sub-component in LNG production can exist without the other components. It is not possible to stockpile products at intermediate steps; the whole production system is highly integrated from the gas production well through to the loading of LNG into LNG tankers. For example:

- Constraints on production that may arise due to change in a shipping schedule are required to be managed by adjusting gas production at the well;
- Electrical power generation is supplied with fuel (end flash gas) from the liquefaction process and a careful balance is required to match fuel supply with electrical demand so as to avoid having to flare surplus end flash gas; and
- Waste heat is often recovered in the liquefaction process and used to provide process heat for the acid gas removal process and where required the subsea production system.

**Figure 5: LNG Industry Process Flow**



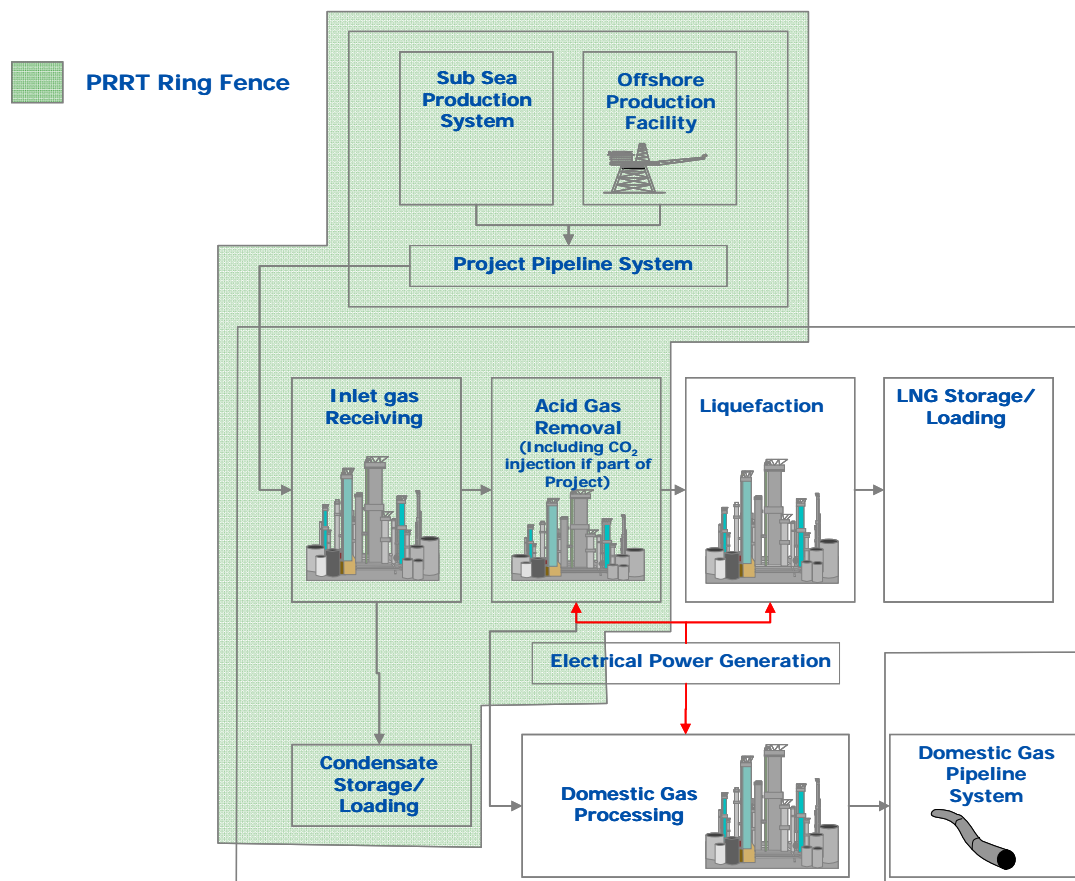
<sup>7</sup> Not shown on these figures is the shipping of LNG, the LNG receiving and regasification terminals and the downstream use of the natural gas. These are important activities but occur outside Australia and the coverage of the CPRS.

While it is possible to determine greenhouse gas emissions from each component and sub-component of the LNG process determining the proportion of costs and revenue streams between each component is highly problematic. In the context of determining taxes on production, boundaries are drawn around particular components of the LNG process; however, these boundaries are dependant upon the various production tax regimes that are applicable to a particular project. The following production taxation regimes may apply to different LNG projects in Australia:

- Excise/Royalty regime currently applies to the North West Shelf Project;
- East Timor Treaty arrangements currently apply to gas produced for the Darwin LNG Project and may apply to other project in that region;
- Petroleum Resource Rent Taxation (PRRT) will apply to future LNG projects sourcing gas from Commonwealth offshore waters;
- Various State Based Royalty regimes will apply to LNG projects sourcing gas from onshore.

As an example of how the PRRT arrangements are applied, Figure 6 shows what is commonly called the PRRT ring fence. In order to determine PRRT payments it is necessary to determine costs for activities within this ring fence and a gas transfer price between the ring fenced activities and the remainder of the plant. The gas transfer price is a complex calculation, unlike the aluminum example given in the Green Paper, there is no marketable commodity produced between the facilities subject to PRRT and the remainder of the LNG facility.

**Figure 6: PRRT Ring Fence as Applied to LNG Projects Sourcing Gas From Commonwealth Offshore Waters**

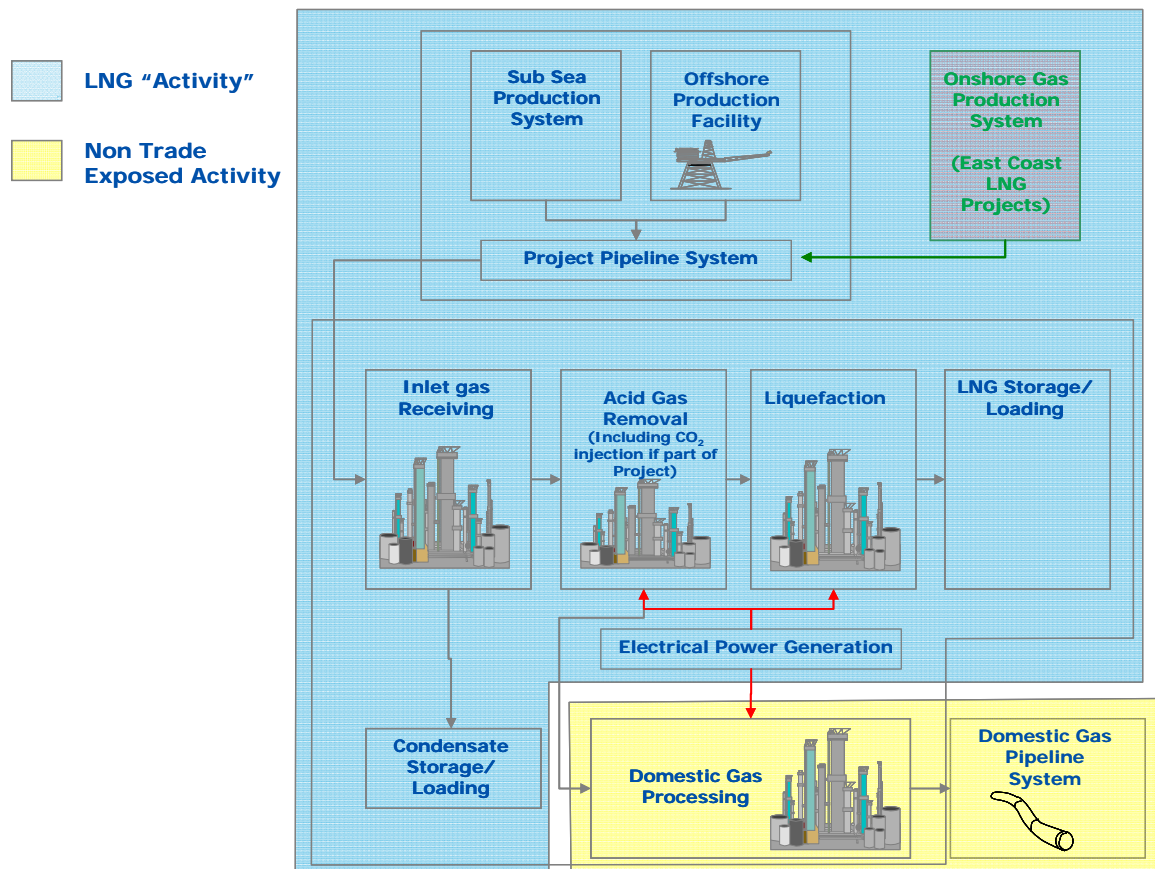


Any attempt to try and disaggregate the LNG process into a number of smaller activities would require complex assessments as to cost and transfer prices between each activity. This would add significant compliance and cost burdens to both the LNG industry and Government for questionable apparent gain.

Should the resulting Government Policy on the CPRS require “activities” to be defined, Chevron propose activity boundaries only be drawn where a readily marketable commodity is produced between each activity.

Applying this principle, the appropriate boundary for defining the “LNG activity” would include both the gas production and LNG processing operations. The activity could be defined as “gas production and LNG processing for export (including all ancillary utilities and support services)”. This is shown diagrammatically in Figure 7.

**Figure 7: Gas Production and LNG Processing For Export “Activity”**



Where an activity produces both a commodity that is trade exposed and a commodity that is for domestic consumption, for example gas that is used for both LNG and domestic gas purposes; this should not be used to further subdivide an activity. Rather the emissions associated with that activity should be prorated to both the trade exposed and domestic components.

## ***Comparing the Emissions Intensity of Different Activities***

The Green Paper makes the contention that assistance to trade exposed industry should only be provided to “the most materially affected activities”. Chevron contends this runs the risk of driving much of the Australian LNG industry offshore. Under the threshold test proposed in the Green Paper it appears as if the LNG industry is not deemed “most materially affected”. This is despite the impact on LNG projects such as those proposed by Chevron incurring a doubling of operating costs (assuming an emissions price of \$50 per tonne).

The Government’s preferred position of using a simple, transparent metric by which to assess the emissions intensities of different activities appears attractive in theory. Chevron would, however, contend that such a test may be difficult to apply in practice given the wide range of industries and the complexity of the Australian economy. For example a particular metric may adequately reflect the impact upon the international competitiveness of industries A and B but fail to reflect the impact on industry C. A metric that reflects the impact on competitiveness for industry C may not work for industry A.

Fundamentally each industry, and even different firms operating within an industry, will have different cost structures and hence the degree to which these cost structures are impacted by the introduction of the CPRS may vary significantly. The use of a single metric to differentiate which firms are most impacted fails to account for the differing cost structures of firms across the Australian economy.

The use of revenue to determine a firm’s loss of competitiveness under the introduction of the CPRS may have been considered as a proxy for the degree to which a firm can afford to pay. However this fails to appreciate that revenue is:

- Used to pay for a firm’s operation costs;
- Applied to the depreciation of invested capital and amortized against future costs such as decommissioning expenses;
- Used to pay government taxes; and
- Provides a return for firms that are willing to take on the risk of investing in a particular activity.

The LNG industry does experience significant flows of revenue but this is used to fund capital investment in the tens of billions of dollars, large levels of production taxation and to provide a return for those firms that were willing to take on the risk of drilling exploration wells knowing that they may not realize production from any resulting discovery for many decades. Even with the significant revenue flows, the return on investment in the LNG industry, particularly for investment in green-field projects is generally low.

Chevron opposes the Government’s preferred position that “emissions per unit of revenue” is the most comparable indicator of materiality of the carbon cost impact across different traded industries.

We observe that since the release of the Green Paper, Government appears willing to consider alternative metrics by which to determine the degree to which industries will have their trade competitiveness impacted. Chevron welcomes this but notes that remaining elements of the proposed model fail to deliver on the Government’s previously stated commitments.

If Government wishes to insist on the use of a single metric by which to determine the degree to which the international competitiveness of particular

industries are impacted by the CPRS, it should use a metric which reflects the impact that the costs of purchasing permits will have on a firm's profit/loss statement. The requirement to purchase emissions permits will be felt by firms as an increase in operating cost (intermediate business inputs) and, as such, operating cost is preferred over revenue, although this may disadvantage industries that have high levels of throughput but operate on a low margin per unit of output.

The use of value added metrics should fully reflect the capital intensity of an industry.

In order to assess which activities are likely to have their trade competitiveness impacted by the introduction of the CPRS and given the widely differing cost structures across Australian industry, Government's decision should be informed by the application of a number of factors such as:

- ◆ Impact on intermediate business inputs (operating costs and labour);
- ◆ Impact on value added (earnings after tax, interest, depreciation, and amortization);
- ◆ Net value at risk (intermediate business inputs relative to value added); and
- ◆ Impact on regional greenhouse gas emissions.

The final activity list should be subject to a sense test to ensure that the list reflects those industries that have a competitive future in the context of a global emissions reduction framework.

### ***Initial Size and Distribution of Trade Exposed Assistance Policy***

It is critical that Government takes the time to ensure the level of assistance to trade exposed industry is correct. Any failure to adequately provide this assistance will have the effect of reducing Australia's emissions but at the cost of negatively impacting, potentially significantly, the Australian economy.

In the absence of the Government modeling of the impact of the CPRS and a clear statement from Government as to its proposed emissions trajectory, indicative gateways and hence the potential value to be placed on emissions permits, Chevron is unclear as to how the Green Paper arrives at the conclusion that 20% of the total available permits should be made available for allocation to trade exposed industry in the non agriculture sectors. This appears to be an arbitrary decision made without detailed consideration for the potential impact on competitiveness of Australian industry.

The level of permits set aside for allocation to trade exposed industry should only be determined once the emissions trajectory has been established and the impact of the resulting price on emissions on the trade competitiveness of Australian industry fully assessed in light of the Government's policy of not disadvantaging Australia's trade exposed industry.

No artificial restraint should be imposed on the ability of Government to allocate emissions permits to new entrants in activities that have been deemed to require assistance as trade exposed.

## ***At What Level Should the Eligibility Threshold for Trade Exposed Assistance Be Set***

Chevron notes that the discussion in the Green Paper relating to the thresholds for determining activities that should receive assistance as trade exposed predisposes that the test of emissions intensity will be based upon revenue. As discussed above, Chevron believes that a revenue metric is an inappropriate measure for determined eligibility as it fails to equitably reflect the varying cost structures between industries in the Australian economy.

Determination of eligibility thresholds should be deferred until the Government emissions reduction trajectory has been released and the impact of the resulting emissions price on industry assessed using a range of metrics which fully reflect the varying cost structures attributable to Australian industry.

In determining the eligibility for treatment as a trade exposed industry, consideration should be given to industries which will have a competitive future in the context of a global emissions reduction framework so as to ensure those industries are not unintentionally restrained during the transition to the global framework.

## ***How Should Assistance Be Distributed Between Eligible Trade Exposed Activities***

Chevron is concerned by the statement in the Green Paper that:

“the Government considers that it may not be possible or appropriate to provide entities conducting EITE activities with full cover for the burden of their emissions liabilities for these activities because of the competing demands on scheme revenue and the additional emissions reduction challenge this would place on non-assisted industries and households”.

Firstly, Chevron argues that increasing the administrative allocation of emissions permits to trade exposed industry does not add any additional emissions reduction challenge on non-assisted industries and households. The burden these sectors face is determined by the overall scheme cap and the prevailing emissions permit price and not to the degree to which individual sectors are allocated emissions permits. These sectors only face an increased emissions reduction burden if the trade exposed activities are placed outside the scheme.

Secondly, Chevron has difficulty understanding the logic that some industries will have their trade competitiveness impacted by the introduction of the CPRS and, therefore require provisions to ensure they are not disadvantaged, but only a limited number of permits are allocated because of concerns about Government revenue.

If an Australian industry (or activity) is considered to have its ability to compete in the international markets impacted by the introduction of the CPRS then that industry must receive an allocation of emissions permits to ensure that it is not disadvantaged by the introduction of the scheme. This can only be achieved by an allocation of emissions permits commensurate with the level of that industry's emissions.

Having determined that an industry's competitiveness is at risk, only allocating a modest percentage of emissions permits would seem inequitable and runs counter to the Government's election commitments as it would place that industry at a disadvantage.

## ***Establishing Emissions Intensity Baselines***

In determining the process by which emissions permits are allocated to trade exposed industries, consideration needs to be given to ensure that firms are exposed to the full market incentive to reduce greenhouse gas emissions and to avoid providing incentives that might drive the premature closure of a facility.

The allocation of emissions permits using intensity tied to production should provide a process that encourages firms to maintain and increase production while reducing emissions per unit of output.

Chevron supports the Government's proposal to develop a series of activity specific Australian average emissions intensities baselines from historical data that would be applied consistently to existing and new trade exposed activities. This should ensure that the baseline data reflect as close as possible Australian operating conditions, although we note that there may still be some environmental factors, such as quality of raw materials that may disadvantage some firms relative to others. Government should give further consideration as to how to address environmental factors which may disadvantage particular firms undertaking an activity.

## ***Assistance to Trade Exposed Entities Over Time***

Accommodating growth in the economy will create pressure on Australia's chosen emissions trajectory and this pressure applies regardless of whether growth occurs in a trade exposed or non trade exposed sector. Until such time as there is a global emissions reduction framework in place, which may take many decades, Government must apply caution in setting Australia's emissions trajectory such that it does not unnecessarily constrain the Australian economy, both in the trade exposed and non trade exposed sectors.

In the context of the provision of assistance to trade exposed industry, Chevron opposes the Government's preferred position that the percentage of available emissions permits set aside to assist trade exposed industry should remain fixed over time.

Fixing the portion of emissions permits to be allocated to any one sector of the Australian economy assumes that the economy does not change with time. Chevron believes that this does not reflect the history of the Australian economy. Over the last several decades the Australian economy has seen a progressive trend away from dominance by non-trade exposed industries towards an economy that has a far larger proportion of trade exposed industries. Chevron contends that this is a global phenomenon reflecting an increased globalization of the world economy and is a trend that should be anticipated to continue. It is therefore vital that, in designing a CPRS, Government does not dictate the degree to which an individual sector can contribute to the economy by permanently allocating fixed percentages of permits to individual sectors.

Consequently the proposal to allow future growth in trade exposed industries by reducing the permit allocation to existing trade exposed industries is not supported by Chevron. Reducing the degree to which existing trade exposed industry is allocated emissions permits to accommodate growth in new entrants is inequitable and runs counter to the objective of not compromising the international competitiveness of these industries.

Government should ensure that permits are allocated to new entrants in trade exposed activities in accordance with the scheme rules, as and when required by the new entrants. This allocation should occur regardless of the percentage of permits already allocated to trade exposed sectors. Should this allocation to new trade exposed entrants result in Australia exceeding its scheme cap or its international obligations, then Government should seek to purchase international emissions units so as to maintain scheme integrity and to honor its international obligations.

### ***Phase Out of Trade Exposed Assistance***

Chevron supports the phasing out of assistance to trade exposed industry only after international action places obligations on an industry's major international competitors.

Full assistance for trade exposed industries should not be withdrawn until the emissions constraints in the competing countries are comparable to those encountered by industry in Australia.

## **SECTION 3: Additional Comments**

### ***Assessment criteria***

In order to promote transparency, Chevron recommends the definitions provided for each of the assessment criteria, by which design options for the emissions scheme will be judged, be expanded in order to provide greater clarity. The following points should be added to the assessment criteria definitions contained on page 85 of the Green Paper:

- **Environmental Integrity** – Emission reductions that cannot be readily verified should not be recognized by the scheme. The acceptance of biological, geological and chemical sequestration should be based on established science.
- **Economic Efficiency** – A single permit price should apply throughout the economy, with no regulatory barriers to cost pass through. Permits should be allocated so as to promote least cost emissions abatement opportunities being undertaken across the economy. In allocating emissions permits, maximizing revenue to Government should not be a policy priority. The permit price should reflect the availability of both supply and demand side technologies to meet the abatement objective. Government should strive to maximize market liquidity while ensuring low transaction costs.
- **Minimisation of Implementation Risk** – The scheme must avoid disruptive economic and energy supply impacts and allow for realistic turnover and phase-in of new, low emissions technologies. The desire to minimize implementation risk should not be used to justify shifting risk from Government to liable parties.
- **Policy Flexibility** – The scheme should promote investment in research and demonstration of low emissions technologies so they can deliver abatement options at a lower cost than is currently anticipated. Policy flexibility should not be used as justification for a shift in risk from Government to liable parties.
- **Promotion of International Objectives** – Australia's actions demonstrably result in more nations adopting credible emissions mitigation actions. As the Australian scheme may serve as a model for other jurisdictions, the application of design options in a broader international context should be a consideration. The design of the scheme should support the measured development of international linkages to other schemes.
- **Implications For the Competitiveness of Traded and Non-Traded Industries** – Australia's trade exposed industries must not be competitively disadvantaged both in terms of production from existing operations and investment in new facilities. The timing of new trade exposed facilities must not be impacted upon by the availability of emissions permits.
- **Accountability and Transparency** – The scheme must support the development of a liquid secondary market that reveals judgments about future permit prices, thereby allowing investors in long lived assets and research and development to manage risk.
- **Fairness** – No one should be required to carry a disproportionate share of the mitigation cost burden. As an offset to any general erosion of competitiveness in the economy as a result of the introduction of this scheme, any excess revenue should be returned to community via a reduction in taxes on capital.

## ***Emissions Targets and Scheme Caps***

As noted earlier in this submission, it is difficult to assess the impact of the Government's preferred position on the CPRS, particularly on trade exposed industry, without the proposed emissions trajectories and likely forward looking emissions price estimate.

It is critical that Government's proposals on medium-term national target range for 2020 and the indicative national emissions trajectory be provided to enable the options in the Green Paper to be assessed and impacts on industry evaluated prior to the finalization of the White Paper.

In setting the eventual emissions trajectory Chevron recommends Government adopt a measured approach mindful of the risks that the Australian economy faces in embracing emissions constraints ahead of our major trade competitors. Consideration should be given to understanding secondary issues such as impacts on inflationary pressures in determining the emissions trajectory.

Chevron supports the proposal to provide multi-year scheme caps and to roll forward the multi-year cap every year. We acknowledge the desire in Government to limit the length of the national emissions trajectory in order to provide flexibility, particularly in the context of global climate change negotiations, but this must be balanced against industries need for certainty. This is a particular issue for new large scale energy projects, many of which have operating lives measured in decades. Extending the multi-year cap would also enable Government to allocate additional future dated emissions permits providing greater future emissions price certainty and liquidity. The availability of long dated permits is likely to be of value to new large-scale energy projects.

Chevron encourages the Government to announce the indicative national emissions trajectory for a period of ten years in order to provide greater long-term certainty, particularly for those looking to invest in major new energy projects. Scheme caps would then be set for a ten year period and extended by one year, each year, as required to maintain a ten year certainty period.

Chevron supports the proposed approach of providing gateways for a number of years in advance of the announced national emissions trajectory. The approach adopted in the Green Paper of providing a combined five year firm cap, plus a further ten years of emissions reduction gateways, may not provide the required level of investment certainty required for major new energy projects. A combined emissions cap and forward gateway process that provides a view of emissions price over a twenty to thirty year period would greatly assist industry in planning for these new projects.

In order to promote investment certainty, particularly for new investment in major energy projects, Chevron proposes that gateways be announced for ten to twenty years in advance of the national emissions trajectory.

Chevron supports the proposal in the Green Paper that the scheme cap would not be adjusted in the event that it is incompatible with internationally negotiated national targets and, if necessary, the Government would make up any shortfall in internationally agreed targets by purchasing internationally traded emissions credits. This provides an equitable balance between firms managing uncertainty associated with working within the proposed scheme and Government, which has the responsibility to ensure that the parameters by which the scheme operates do not change.

As sectors not currently covered by the CPRS are added to the scheme it is important that the transition does not introduce unintended volatility to the prevailing emissions trading price. It is important that only sectors in which emissions can be accurately measured are admitted to the scheme in order to maintain credibility and confidence in the scheme.

Where uncovered sectors are to be brought into the scheme, Chevron supports the option that Government announce the detailed rules by which the sector will be included and the resulting increase in the scheme cap at least two years in advance of transition.

## ***The Price Cap***

Chevron supports the concept of some form of safety valve to protect the economy and trigger relief remedies in the event of unintended price volatility. Preventing short term volatility in emissions price is critical in building market confidence and driving investment in emissions abatement opportunities. The use of a price cap can play a role in managing this price volatility particularly in the early years of the emissions trading scheme.

Chevron supports the use of a price cap in the early years of the scheme but notes the proposal to set the price high enough such that the probability of its use is very low, suggests that it will only be effective in managing extreme price movements. In the context of effective mechanisms to manage price volatility, it is questionable if such a price cap is of any value.

Consideration of the level at which the price cap is set during the early years of the CPRS should be based on a thorough analysis of the impacts on industry and employment at several different price levels. The price cap should be set at a level that would avoid unintended impacts on the Australian economy.

The cap should be set at a level where it represents a true safety valve but not so high that it is only likely to be rarely used as this defeats the purpose of such a mechanism in managing price volatility.

Chevron supports the proposal to review the price caps and that its role in effectively managing price volatility in regular scheme reviews.

The structure of the price cap as a penalty and make good provision has the advantage of preserving Australia's emissions reduction trajectory, however, use of make good provisions may contribute to permit price volatility in the subsequent permit year. The use of a penalty to provide a scheme cap is also problematic for firms that are prohibited from knowingly undertaking an activity that will result in a penalty, either due to legislative or internal policies.

The sale of additional permits at a pre-set price, in order to limit price volatility will result in an increase in Australia's scheme cap, however, Chevron believes this is preferable to allowing price volatility which will undermine confidence in the emissions market. This may have impacts on maintaining alignment between scheme caps and international commitments but these can be managed through the purchase by Government of international permits.

Chevron recommends the price cap being structured as an unlimited store of additional permits, sold by the Government at a fixed price.

## ***Intertemporal Flexibility***

Preventing short term volatility in emissions price is critical in building market confidence and driving investment in emissions abatement opportunities. Thus Chevron supports the proposal to allow unlimited banking of permits in order to lessen market volatility. Additionally, Chevron supports allowing liable parties to borrow permits to meet annual acquittal liability. Both banking and borrowing are effective mechanisms to avoid short term price volatility in the price of emissions permits.

## ***Auctioning of Australian Carbon Pollution Permits***

As the CPRS is an artificially constructed market, Government must consider how best to create the market. That is: how to efficiently supply the economy with the correct number of emissions permits.

The Green Paper puts forward the advantages of auctioning as an allocation method but does not compare this with alternative methods of permit allocation.

Chevron believes that the administrative allocation of emission permits is both economically and environmentally efficient. Auctioning of allowances, especially in the early years of a program, imposes substantial new costs on businesses and the uncertainty around managing internal cash flow is likely to slow down needed investments in the technologies needed to achieve emission reductions.

Chevron observes that there is limited global experience in environmental markets with allocating the bulk of emissions permits via the auction process. Neither the European Union Emissions Trading Scheme nor the North American Acid Rain program, two established emissions trading schemes, currently auction more than a small portion of the total volume of permits allocated under each scheme. For example the North American Acid Rain program auctions only 2.8% of the total permits.

Government must recognise that extensive use of auctioning of emissions permits as the primary permit allocation method at the inception of the market is in itself an experiment. Careful consideration is required to assess unintended consequences auctioning may have for the performance of the scheme compared with other alternatives.

In designing the auction process, issues such as market efficiency should receive precedence. Opportunities to maximise Government revenue should not be considered a motivating force in auction design as this simply places greater costs on industry and households for no environmental gain.

Secondary impacts on matters such as inflation need to also be carefully considered given the auction model implies a large portion cost pass through to households, not just in the first year of scheme implementation, but increasing in subsequent years as the emission permit prices increase. It is possible that alternative scheme designs may be equally environmental effective but have less secondary impacts.

The proportion of emissions permits to be auctioned should be determined only once the commitment to not disadvantage Australia's trade exposed industry has been fully delivered and the number of permits allocated to trade exposed industry determined.

## ***Acquittal Liability***

As a significant supplier of domestic gas in the Western Australian market, Chevron acknowledges the engagement between Government and the gas production industry in developing the proposed acquittal points for emissions from domestic gas use. Chevron supports the proposals presented in the Green Paper in relation to emissions from domestic gas use.

Chevron supports the proposed arrangements in relation to the treatment of Carbon Capture and Storage.

The Green Paper is silent on the management of permit acquittal liabilities where facilities are jointly owned such as the joint venture arrangements commonly entered into in the oil and gas industry. Ultimately, where a facility is jointly owned each of the owners of that facility should be able to manage its "carbon emissions liability" independently and in much the same way as taxation issues are currently managed. This could be achieved by either:

- An administrative allocation of emissions permits that could be made to the individual owners of the facility and those owners would be separately responsible for acquitting their proportional share of emissions permits for the facility; or
- An administrative allocation that could be made to a nominated responsible entity and that responsible entity could be charged with acquitting the required emission permits for the facility. Any allocation of emissions permits would be transferred from the nominated entity to each of the joint owners upon the allocation. The joint owners would be responsible for ensuring the responsible entity was provided with sufficient emissions permits prior to their acquittal. Within this framework, each joint owner would manage any surplus or shortfall in emissions permits separately.

Arrangements such as those proposed above would not preclude one party contracting with another party to manage its carbon emissions liability.

In designing the CPRS, Government should ensure that constraints are not imposed upon jointly owned facilities (activities) that preclude the owners from managing their "carbon emissions liability" separately.

The Green Paper is silent on the acquittal liability for emissions from contractors who provide integrated services within a facility. Chevron is concerned the definition of "Operational Control" as used in the National Greenhouse and Energy Reporting Act 2007 (Commonwealth) is open to interpretation. As such, disputes may arise in relation to acquittal liability for contractor emissions within a facility.

Chevron recommends that Government allow acquittal liability for contractor emissions within a facility to be specified in the contractual arrangements for that facility. Government should recognise these contractual arrangements in determining acquittal liabilities for a facility.

## ***Reporting and Assurance***

Chevron supports the use of existing monitoring and reporting protocols in order to reduce compliance costs associated with the introduction of the scheme.

Accordingly Chevron supports the use of the National Greenhouse and Energy Reporting Act 2007 (Commonwealth) (NGRES) as the starting framework for emissions reporting and assurance under the CPRS. Chevron acknowledges that elements of NGRES may have to be strengthened to accommodate the financial assurance required under the CPRS.

Chevron notes that industry is still adopting the reporting requirements imposed by NGRES and that several reporting periods should be allowed prior to the implementation of the CPRS to ensure that the data in the system is robust and reliable.

Chevron supports the Government's proposal that annual emissions reports be assured by an independent accredited third party prior to submitting the reports to government. Our experience in other environmental markets has shown that independent assurance contributes credibility of the market.

## ***Compliance and Enforcement***

The need for a robust compliance and enforcement regime is critical to underpin confidence in the CPRS and is supported by Chevron.

As stated earlier, Chevron is concerned about an unachievable timetable for the implementation of the scheme. It is important that detailed provisions dealing with compliance and enforcement are framed recognizing that industry will require time to prepare for the implementation of the CPRS. Chevron's experience in the European Union Trading Scheme suggests that assurance checks on individual firms' emissions may be one area that may cause problems until sufficient capacity is established for the provision of accredited third party services. As the scheme is proposed to commence shortly after the finalization of legislation, Government should anticipate a range of compliance issues in the early years for the scheme that may take several years to resolve.

The risk of non compliance in the early years of the scheme should be addressed by adopting a realistic implementation time table.

Chevron would support implementation of the scheme on a timetable that allowed industry adequate time to prepare. If Government rushes implementation it should set a "compliance assistance" period where companies are not penalized for compliance breaches.

Chevron supports the proposals in relation to compliance and enforcement contained in the Green Paper but if government maintains its proposed 2010 implementation date, it should ensure a measured approach to compliance and enforcement until such time as industry has been able to adapt to operate under the CPRS.

## ***Linking the Scheme to International Markets***

Chevron supports the policy objective of designing the scheme so that it can link with international markets within an effective global emissions framework.

In developing an environmentally efficient climate change policy the gross level of emissions within a particular jurisdiction is irrelevant -- what is important is a global reduction in emissions. In the context of developing Australia's climate change policy, consideration needs to be given not just to Australia's emissions, but also to the contribution Australia can make to reducing emissions in other

jurisdictions. The benefit of the Australian LNG industry in lowering emissions in other countries underscores this point

The Green Paper correctly identifies linkages as the mechanism to achieve a net global reduction in emissions with the resultant focus on Australia's net emissions trajectory rather than on Australia's gross emissions.

Support for linkages does, however, have some disadvantages in that importing emissions units from markets lacking in credibility will undermine the environmental efficiency of the CPRS. Chevron supports placing restrictions on international linkages only where there are real threats to the stability and ongoing credibility of the CPRS.

The relatively small scale of the proposed CPRS, compared with markets such as the European Union Trading Scheme and similar proposed markets in North America, means that unconstrained linkages with those markets will result in a disconnect between the Australian emissions reduction trajectory and the resulting emissions trading price. This should not be used as a reason to avoid linkages to those schemes.

### ***Domestic Compliance Units and the Kyoto Protocol***

Chevron supports establishing an "Australian emissions unit" as distinct from "Australia's international (Kyoto Protocol) units". A similar approach should be taken in any post Kyoto type agreement of maintaining separation between Australian compliance units and any international commitment units. This separation provides the Government with flexibility to meet Australia's international commitments while limiting impacts on the Australian economy.

There may be situations where Government wished to adopt a more stringent emissions reduction target in negotiating a future international agreement. A separation of Australian and international commitment units would provide flexibility for government to achieve this without changing the previously announced cap. Government could resolve any difference between the Australian scheme cap and the newly agreed international agreement by purchasing internationally traded permits.

<p>Chevron supports the Governments preferred position of maintaining separation between the "Australian domestic compliance unit" and any international compliance unit so as to provide greater flexibility in managing Australia's emissions and international obligations. This separation should apply not just to international units under the Kyoto Protocol but to any units negotiated under successor agreements.</p>
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The Kyoto Protocol acknowledges that as far as the global climate is concerned, it is immaterial if the source or sink of greenhouse emissions is located in Australia or some place else this through its flexibility mechanisms; the Clean Development and Joint Implementation Mechanisms. The Clean Development Mechanism has the added advantage of enabling technology and capital transfers from the developed to developing economies. The technology transfer that may accompany Clean Development Mechanisms Projects is of vital importance in assisting developing economies to reduce their emissions.

Given the respective market sizes and that the Clean Development Mechanism market is relatively mature compared to the proposed CPRS, it is unlikely that price volatility in internationally traded units (Certified Emissions Reduction Units for example) will exceed the price volatility of the Australian scheme. As such, we see little value in restricting the degree to which these international units are

used to meet obligations under the CPRS on the grounds of minimizing implementation risk. The only justifiable support for limiting the import of units such as those under the Kyoto Protocol flexibility mechanisms would be on grounds that the supposed emissions reduction was not credible.

Chevron rejects the argument that processes such as the Clean Development Mechanism provides a disincentive for developing nations to embrace their own emissions reduction targets. There are many drivers and restrainers on nations to adopt binding emissions reduction targets and it is difficult to see how processes such as the Clean Development Mechanism alone would significantly influence such a decision.

Chevron supports and would encourage international linkages via the Kyoto Protocol's flexibility mechanisms as soon as possible after the implementation of the CPRS. These linkages should extend to similar processes established under any successor agreement. Arbitrary constraints should not be placed on the degree to which these international units are used to meet obligations under the Australian scheme cap.

Government should facilitate the effective banking of Kyoto Protocol type units. For Certified Emissions Reduction Units created prior to the end of 2012, Government should exchange these for Australian Emissions Units.

Chevron acknowledges the Government's concern with regard to Assigned Amount Units issued during the first commitment period of the Kyoto Protocol and that recognizing these units in complying with the CPRS may have an impact on the credibility of the Australian scheme. It is anticipated that concerns with Assigned Amount Units in future Kyoto Protocol commitment periods or similar units under a successor global agreement should be resolved, in which case Government should allow unrestricted use of these units for the purpose of complying with the CPRS.

Chevron does agree that international non-Kyoto units should not be accepted for compliance in the CPRS. A position on the acceptance or otherwise of these non-Kyoto units is best made at some future point in light of developments in international negotiations for a global emissions reduction framework. As a matter of principle, Australia should accept any international emissions units towards compliance with the CPRS, provided such units are credible.

### ***Sale and Transfer of Domestic Abatement To International Markets***

Chevron agrees with Government that the ability to sell Australian permits into international markets is desirable and should be a feature of longer term linking arrangements. Chevron acknowledges that allowing such transfers may increase demand for emissions permits in the CPRS with the consequence of driving Australian emissions prices upward. Such a situation would imply that abatement opportunities in Australia were of lower cost than those available in the international market. In such a case, restrictions on the ability to sell Australian permits on the international market would effectively result in emissions abatement in other countries being potentially more costly than would otherwise have been the case. In the context of the desire to reduce global greenhouse gas emissions, this would appear to be an inequitable policy response.

The ability to sell Australian permits into international markets should only be constrained where concerns exist about the credibility of that international market. Where the international market is credible and robust, Government

should not impose constraints on the ability to sell Australian permits into that market.

## ***Tax and Accounting Issues***

Chevron supports the objectives of tax neutrality, cost effectiveness and simplicity in considering how best to deal with taxation issues associated with the introduction of the CPRS.

The Government's proposed position is to provide tax neutrality between emissions abatement options and in managing compliance with the CPRS. This will require complimentary changes to the tax laws so that taxpayers choosing between alternative emissions abatement activities, for example investment in low emissions plant and equipment or in purchasing emission permits, do not face distortions imposed by differing taxation treatment.

In order to ensure this tax neutrality, Chevron proposes that concessional tax treatment of capital expenditure in low emissions technologies be available. This may take the form of:

- Immediate deductibility for investment in capital equipment;
- Increased rates of deduction for low emissions related R&D expenditure (over and above the existing rates);
- Advantageous/accelerated capital allowances incentives for investment in cleaner energy projects, such as LNG; and
- Investment allowances (for example, a deduction of 125% of expenditure incurred).

Chevron supports the proposal to develop discrete provisions in the income tax law to apply to the administrative allocation, purchase, sale and acquittal of emissions permits and that these provisions would provide generally the same treatment regardless of the source of the permits. The development of discrete provisions in the income tax law should provide certainty and reduce complexity for industry.

## ***Dealing With Timing Issues Under The Income Tax System***

Chevron supports the Government's preferred position that the purchase of emissions permits should be deductible at the time the permit is acquired and that any proceeds received from the sale of emissions permits should be treated as assessable income for income tax purposes.

The "rolling balance method", which is proposed to be used to ensure that permits are brought to account for income tax purposes at the point of use, is similar in nature to the current regime used to account for trading stock and is a reasonable approach to managing taxation issues associated with holding of emissions permits. However, a number of issues will need to be addressed in any final proposal by Government:

- Taxpayers should be allowed flexibility to choose between cost and market value in valuing closing stock for tax purposes so as to avoid incurring a tax liability on unrealized gains;
- The appropriate treatment of allocated permits needs to be addressed in the closing stock calculation to avoid double taxation (where allocated permits are taxed on receipt and potentially again if still on hand at the end of the year);
- Timing issues may arise where emissions permits are acquitted after the end of the tax year for that years emissions liability. Permits acquitted for

a particular tax years emissions liability should be treated as having been acquitted in that tax year; and

- Clarification on the process of permit acquittal is required where a facility is operated by multiple entities such as a Joint Venture.

### ***Recognising Direct Government Assistance For Liable Entities Under the Income Tax System***

Including the value of any administrative allocated permits in a taxpayer's assessable income appears to be consistent with the taxation of other forms of Government assistance such as benefits and grants but a number of issues require further consideration:

- The degree to which assistance offered in the form of an administrative allocation of permits will be diluted to the extent income tax, and importantly for the oil and gas industry Petroleum Resource Rent Tax, liability arises on receipt of the emissions permit;
- Taxpayers with differing tax profiles (for example firms with taxable income as opposed for firms with accumulated tax losses) will effectively receive different after-tax benefit. This is a particular issue in relation to the application of Petroleum Resource Rent Tax where firms may have different exposures to this tax as a result of differing levels of historical exploration expenditure; and
- The preferred "rolling balance" position needs to be appropriately designed to ensure no double taxation of administratively allocated permits.

A potential solution to the issues raised above is to tax permits on an incurred (i.e. cash) basis, with modifications for permits not acquitted during an emissions year. This could be achieved by:

- A tax deduction would be available on acquisition of the permits;
- Sale proceeds would be treated as assessable income on the disposal or acquittal of the emissions permit; and
- Application of an apportionment methodology similar to the current prepayment rules designed to spread the cost of an emission permits over its holding period where the permit is not acquitted in the year of acquisition.

### ***Income Tax Treatment Of Penalties For Non-Compliance***

The compliance and enforcement provisions proposed under the scheme, including penalties, have yet to be developed. Accordingly it is not known whether any penalty will be in the form of a levy, 'safety valve' fee or other charge. Although the non-deductibility of any penalty is consistent with the treatment of other penalties for tax purposes, such a treatment communicates that this is not a "safety valve" mechanism, but rather a true penalty. To the extent that any ultimate penalty is non-deductible, we submit that Government take this into account in setting the level of the penalty.

### ***Goods and Services Tax***

<p>Chevron recommends that the discrete provisions be implemented as part of the income tax laws to clarify issues related to the treatment of scheme transactions for the purposes of the Goods and Services Tax so as to provide increased certainty for Australian industry.</p>
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## ***Petroleum Resource Rent Tax***

Chevron notes that no proposals for the taxation of the scheme under the Petroleum Resource Rent Tax (PRRT) regime have been formulated as part of the Green Paper. Chevron appreciates the opportunity to work with Government in determining the appropriate application of the PRRT to transactions envisaged under the scheme. As a preliminary measure, Chevron proposes the following points are needed to be satisfactorily resolved in order for a workable and equitable outcome in relation to the PRRT:

- Costs associated with acquiring permits with the necessary connection to a PRRT defined petroleum project should be deductible for PRRT purposes;
- As the PRRT regime only allows deductions for expenditure in relation to a PRRT defined petroleum project, it is essential that there be a mechanism to recognise the appropriate nexus between the purchase of a permit, and the allocation to a particular project.
- On a similar note, there needs to be an opportunity for taxpayers to choose other abatement activities and have the costs attributable to the PRRT project. Failure to do so would create inequitable distortions in abatement decision making;
- Specific provisions within the PRRT legislation should be introduced to deal with taxation issues arising under the scheme;
- The sale of permits should fall within the PRRT regime, but only to the extent of historical cost plus augmentation (any gain or loss on permits should be outside of PRRT regime), and only to the extent a PRRT deduction has been claimed for the costs associated with acquiring that permit; and
- The payment of non-compliance penalties/safety valve payments should be deductible for PRRT purposes in accordance with current PRRT treatment of penalties.

Similar issues arise for those petroleum projects that are subject to royalty regimes as opposed to the Petroleum Resource Rent Tax. Chevron would be pleased to participate in any process to determine the royalty treatment of scheme transactions, and make the point that costs associated with the scheme should be post-wellhead costs, and therefore deductible for royalty purposes.

## **SECTION 4: Additional Consultation**

As stated previously, Chevron supports an approach to climate change policy that is transparent, encourages global emissions engagement, promotes energy security, maximizes energy efficiency and conservation, is measured and flexible, has broad equitable treatment and enables technology. Chevron understands the difficulty faced by the Australian government in its efforts to balance the desire to design a program to reduce greenhouse gas emissions in advance of a global commitment with maintaining the competitiveness of Australia's trade exposed industry. However, Chevron is unable to support the Government's preferred design options because the model for dealing with trade exposed industry would expose Australia's LNG industry to significant increases in cost and thereby reduce the ability of this industry to compete fairly in international markets.

It is vitally important for the Australian economy that a workable proposal for preserving the competitiveness of Australia's trade exposed industries be developed. This will require greater consultation with those industries and a willingness by Government to consider alternative design options in order to find a scheme that supports emissions reductions while preserving the international competitiveness and future growth in those industries and the nation.

Chevron remains committed to continued participation in the discussion of policy options surrounding emission reduction schemes and urges the Government to continue to engage in detailed consultation with all affected industries in order to fully understand and account for the impacts that such a scheme will have on their competitiveness and prospects for future growth.