



## Submission: Exposure draft of the Carbon Pollution Reduction Scheme legislation

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#### Confidentiality

We are happy for this submission to be treated as a public document and understand that the submission may be published on the Department of Climate Change website

#### Personal Information

This submission does not contain personal information of third party individuals.

## **Executive Summary**

Chevron Australia Pty Ltd (Chevron) welcomes the opportunity to provide this submission to the Department of Climate Change into the exposure draft legislation to implement the Carbon Pollution Reduction Scheme (CPRS).

Chevron supports a climate change policy approach that is transparent, encourages global emissions management, promotes energy security, maximises energy efficiency and conservation, is measured and flexible, has broad equitable treatment, and enables technology.

Chevron supports the move toward a well designed emissions trading scheme as Australia's primary policy response for regulating greenhouse gas emissions. We see a well designed emissions trading scheme as being more environmentally effective and economically efficient in delivering lowest cost emissions reductions than the current plethora of ad hoc policy responses currently being applied to regulate greenhouse gas emissions.

There are many elements of the Carbon Pollution Reduction Scheme (CPRS) – including banking, acquittal points for domestic gas and greenhouse gas storage, monitoring and assurance provisions and international linkages – which Chevron views as key aspects of a workable emissions management scheme. However, Chevron remains concerned that the proposed CPRS fails to adequately address the negative impacts on the international competitiveness of Australia's liquefied natural gas (LNG) industry during the period leading up to a global emissions reduction framework. This is likely to provide a motivation for existing industry to relocate away from Australia and a disincentive for new investment within Australia. By placing additional economic barriers in front of the further development of Australia's LNG industry, it may also lead to a significant increase in global greenhouse gas emissions than might otherwise have occurred.

In this submission we propose a number of changes to the treatment of trade exposed industry which will maintain both the economic incentive for those industries to reduce their emissions and at the same time preserve their ability to compete in international markets.

Please note that given the short timeframe provided for comment on the draft legislation, our comments in this submission are not exhaustive and should be considered preliminary.

## **About Chevron**

Chevron Corporation, through its subsidiaries and affiliates, operates across the entire energy supply spectrum. Chevron's interests include exploring for, producing and transporting crude oil and natural gas and refining, marketing and distributing petroleum fuel. We also generate electrical power, design and market large-scale energy efficiency solutions and are working toward commercialising the energy resources of the future, including bio-fuels and other renewable energy. Chevron is the world's largest producer of geothermal energy and maintains one of the largest hydrogen transportation fuel infrastructures in the United States of America. Chevron Corporation employs approximately 62,000 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 Project, an interest in the Browse LNG Project and we are a 50 percent equity owner and operator of the Gorgon Project. Both the Gorgon and Wheatstone Projects will supply LNG to international markets and domestic gas to Australian markets.

The Greater Gorgon area gas resource comprises approximately 25 percent 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. The Gorgon Project will be the single largest investment ever undertaken in Australia and will create around 6000 construction and more than 3500 direct and indirect permanent jobs in Western Australia. The project will boost Australia's gross domestic product by \$64 billion and add approximately \$40 billion to government revenue through taxes and charges.

Ongoing efforts to reduce greenhouse gas emissions from the Gorgon Project have resulted in a reduction in emissions intensity such that the proposed project will be one of the world's most greenhouse gas efficient sources of LNG. A significant factor contributing 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. The Gorgon Joint Venture's voluntary commitment to invest more than \$1 billion to

reduce the emissions footprint of the Gorgon Project is a clear demonstration of an overall project commitment to tackling greenhouse gas emissions.

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

Natural gas is widely recognised as having around half the lifecycle 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 in satisfying this increasing demand for energy while reducing the growth in global emissions, particularly in the short to intermediate term.

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 lifecycle 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 natural 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 approximately 45 million tonnes less global 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. Australia has the potential to support possibly five or six new LNG projects of the scale of Gorgon. If all these projects were delivered this could contribute to a global reduction in greenhouse gas emission in excess of 200 million tonnes per annum.

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.

### **The Carbon Pollution Reduction Scheme**

There are many elements of the CPRS – including banking, acquittal points for domestic gas and greenhouse gas storage, monitoring and assurance provisions and international linkages – which Chevron views as key aspects of a workable emissions management scheme. However, Chevron remains concerned that the proposed CPRS fails to adequately address the negative impacts on the international competitiveness of Australia's trade exposed industry, such as LNG, during the period leading up to a global emissions reduction framework. This is likely to provide a motivation for existing industry to relocate away from Australia and a disincentive for new investment within Australia. By placing additional economic barriers in front of the further development of Australia's LNG industry, it may also lead to a significant increase in global greenhouse gas emissions than might otherwise have occurred.

The requirement for trade exposed industry to purchase emissions units is justified as providing those industries with an economic incentive to reduce their emissions. This justification confuses the process of creating a market by either the auctioning or allocation of emissions permits, with a firm's economic motivation to reduce its emissions which is provided by the prevailing price of an emissions unit in the market. Auctioning or allocating emissions units is a choice about how to establish the market, and only affects the functioning of that market where the cost of purchasing those units can be passed onto a firm's customers. Where these costs can not be passed on the choice between auctioning and allocation does not effect the functioning of the market or the ability of a particular firm to reduce its emissions. Requiring trade exposed industries, such as LNG, to purchase emissions units creates additional costs to those industries without increasing the economic motivation for that industry to reduce its emissions.

Part 8 of the draft Carbon Pollution Reduction Scheme Bill 2009 states that one of its objectives is to "reduce the incentives for such an [emission-intensive trade-exposed] activity to be located in, or relocated to, foreign countries". Chevron submits that this objective should be to 'remove' rather than 'reduce' the incentive for firms to relocate from Australia. The acknowledgement in the draft Bill that under the CPRS there should remain some incentive for firms to relocate from Australia is a concern to Chevron.

## ***Allocation of Emissions Units and Trade Exposed Industry***

The Government has proposed that a large proportion of Australian emissions units be auctioned in order to promote allocative efficiency and price discovery.

The auctioning of emissions units will expose domestic consumers to the price of the embedded emissions in domestically sourced products and services they purchase. This is achieved by allowing firms trading in the domestic market to pass on the costs of purchasing emissions units to the degree their products are competitive with respect to embedded greenhouse gas emissions. This ensures that emissions abatement opportunities such as switching to alternative products or improved energy efficiency are embraced by sectors in the economy such as households that do not have a direct acquittal liability.

The ability to pass on these costs ensures that Australian industry supplying the domestic market is exposed to the full economic incentive to reduce emissions but without incurring a net overall increase in costs (provided the firm is selling a product that is competitive in light of its embedded greenhouse gas emission).

This is in contrast to the situation faced by many trade exposed industries who supply products where prices are set on international markets. These industries are unable to pass on the additional cost of having to purchase emissions permits. The design of the CPRS partially addresses the imposition of additional costs on these industries through the limited administrative allocation of emissions permits to some industries. However it remains the case that many industries competing in international markets will be forced to absorb the cost of purchasing a significant volume of emissions permits, undermining the ability of these industries to compete in international markets.

In effect, the Government has designed a scheme where all industries included in the coverage of the scheme, are exposed to the same economic incentive to reduce emissions. However trade exposed industries are being required to absorb an additional cost associated with purchasing emissions units, while industries supplying domestic goods are able to pass this cost onto their customers. The requirement for trade exposed industry to absorb the cost of purchasing emissions units has the same economic impact as an additional tax on production without changing the economic incentive for that industry to reduce its emissions.

Chevron proposes that this could be addressed by:

- Increasing the notional volume of emissions units for the administrative allocation of permits to trade exposed industry in the early years of the scheme - from the current 25 percent (excluding agriculture) to as much as 40 percent.
- Removing the emissions intensity test and basing the eligibility for an allocation of permits solely on the level of competition each industry faces from nations yet to embrace comparable emissions constraints and the ability of the Australian firms in that industry to set international commodity prices. In order to maintain the competitiveness of Australia's export and import competing industries, the emissions unit allocation should be set at a level in excess of 95 percent of the industry's historical emissions intensity per unit of production.
- If emissions unit allocation is to remain subject to an emissions intensity test, the metric used to determine intensity should be changed to a metric which considers the impact on an industry's cost structure. Chevron has consistently argued that a more equitable test by which to determine permit allocation should be the impact of the CPRS on an industry's 'Intermediate Business Inputs' (operating and labour costs) or the 'Net Value at Risk' (the ratio of intermediate business inputs relative to value added).
- Regardless of the methodology adopted, emissions units should be allocated to those industries such as LNG that could potentially facilitate a net global reduction in greenhouse gas emissions. Chevron recognises that the allocation of emissions permits would be a transitional arrangement until a global emissions reduction framework is in place.
- Alternatively, if a 'revenue' based test is to remain, then the loss of international competitiveness faced by Australian industry could be limited by reducing the current 2000 tonnes per million dollars of revenue threshold to some level below 1000 tonnes per million dollars of revenue. That is, all firms with an emissions intensity of greater than 1000 tonnes per million dollars of revenue would receive a 95 percent or higher emissions unit allocation based on historical levels of emissions intensity.

- The 'value add' eligibility test, as currently proposed, disadvantages those industries that employ capital (or labour) to create value. This is of particular concern for capital intensive industries such as LNG. It also fails to consider the impact of resource rents, such as the Petroleum Resources Rent Tax (PRRT) on a firm's operating cost structure. If the 'value add' eligibility test is to remain then it should be redefined as revenue, less intermediate business inputs, less labour costs, less resource rents, less depreciation, less amortisation.
- The proposed 1.3 percent annual reduction in emissions unit allocation simply imposes an increasing cost on large facilities. It provides no further economic motivation for firms to reduce their emissions. Annual efficiency improvements are extremely difficult and prohibitively expensive to achieve in the LNG industry where plants have an effective lifespan of 30 – 40 years. This is further compounded by the natural production decline from the natural gas reservoirs which require an increase in the energy and emissions to produce a given volume of product. The arbitrary reduction in annual permit allocation should be removed.

Importantly these changes would not impact upon the economic incentive of industries receiving an allocation of emissions units to reduce their emissions. As discussed above this economic incentive is provided by the industry's marginal cost of abatement and the prevailing emissions price. Consequently these changes would not impact upon the overall level of emissions reduction achieved across the economy.

## Carbon Pollution Reduction Scheme Bill

Part/s	Division/s	Clause/s	Comment
1		3 - Objects	<p>The Objects contained in the exposure draft Bill could usefully extend to a brief overview of how it is proposed to achieve those Objects. For example Clause 3(4)(b) could be replaced with a new Clause 3(5) along the following lines.</p> <p style="margin-left: 40px;">(5) The fourth object of this Act is to ensure that emissions reductions are achieved in a flexible manner and at the lowest possible cost to the Australian economy. This will be achieved by:</p> <ul style="list-style-type: none"> <li>i. imposing a consistent market price on greenhouse gas emissions across as much of the Australian economy as practicable;</li> <li>ii. by facilitating the international trade in credible and verifiable emissions units;</li> <li>iii. by addressing trade competitive distortions during the period prior to a global emissions reduction framework that imposes comparable emissions costs on all goods and services; and</li> <li>iv. positioning the CPRS as the principle policy response used to regulate greenhouse gas emissions.</li> </ul>
1		4 - Simplified Outline	<p>Dot points eight, nine and ten could more accurately summarise the effect of the draft Bill.</p> <p>We suggest that these dot points be revised to reflect that:</p> <ul style="list-style-type: none"> <li>• the Bill provides for emissions units to be issued either as a result of an auction or by administrative allocation and both will occur.</li> <li>• the national scheme cap limit applies to units issued both by auction and by administrative allocation..</li> </ul>
1		5 - Definitions	<p><b><i>recognised transformation</i></b></p> <p>The draft Bill provides</p> <p style="margin-left: 40px;">each of the following is a <b><i>recognised transformation</i></b> of an eligible upstream fuel to another type of eligible upstream fuel:</p> <p style="margin-left: 80px;">(d) the transformation of natural gas to liquefied natural gas;</p> <p>The process for the production of liquefied natural gas is highly integrated with the process for the production of natural gas . One process cannot exist without the other, there are no opportunities to substitute alternative inputs and outputs between the steps in the production of liquefied natural gas, nor is there any storage or stockpiling between the natural gas production and liquefied natural gas production. Chevron therefore proposes that part (d) of the definition of recognised transformation be amended to read as follows:</p> <p style="margin-left: 80px;">(d) the transformation of natural gas to liquefied natural gas, including the production of natural gas for the purposes of that transformation.</p>
2		14 – National scheme cap; and 15 – National scheme gateway	<p>Consideration could be given to defining the terms “major economy” “advance economy”; and “voluntary action”.</p>

3		General Comment in relation to jointly owned facilities	<p>While it is the Government's intent to only deal with one person who has operational control of a facility, further consideration should be given to how these arrangements will operate with respect to joint ventures. In a joint venture the participants select one person to have operational control of the facility (the "operator")</p> <p>The concept of the person having operational control of a facility being responsible for the emissions reporting as is currently the case under the <i>National Greenhouse and Energy Reporting Act 2007 (Commonwealth)</i> is appropriate. However, each participant should be liable for its participating interest share of the emissions from the facility. If the liability is imposed on the operator in the first instance, then the operator should be entitled to transfer a participating interest share of the liability to each venturer by use of a liability transfer certificate.</p>
3	4	35 – Liable entity – supply of transformed eligible upstream fuel (and other Clauses in Part 3 Division 4)	<p>It is unclear whether an Australian producer of a transformed eligible upstream fuel such as liquefied natural gas, incurs a scheme liability in relation to the embodied emissions within that fuel where that fuel is produced in Australia but exported to international markets.</p> <p>It appears as if the producer of the transformed eligible upstream fuel incurs a liability for the embedded emissions unless that fuel is supplied to another person and that person quotes an OTN.</p> <p>In practice requiring persons (firms) located outside the Australian jurisdiction to quote an OTN for goods exported from Australia would add a regulatory burden to a large number international based firms and may provide a barrier to the export of Australian fuel products.</p> <p>The provisions in Part 3 Division 4 of the draft bill should make it clear that there is not a scheme liability for eligible upstream fuels that are exported from Australia.</p> <p>If a cargo of fuel is destined for export then no scheme liability should accrue.</p> <p>If a cargo is subsequently redirected back to Australia then it could be then dealt with as an import and not a domestically produced fuel.</p> <p>This might be addressed through amendment to the definition of "person" to specify a person undertaking activities within Australia. Alternatively, provisions that better define the obligation for embedded emissions in eligible upstream fuels that are exported from Australia could be provided in the bills.</p>
4	5 Subdivision E	68 – Quotation of bogus OTN	<p>Clause 68 (2) places a requirement on the supplier of an eligible upstream fuel to confirm that a recipient has a valid OTN by reference to the OTN Register.</p> <p>This places an unreasonable regulatory burden on suppliers and we therefore recommend the deletion of Clause 68(2).</p>
5		General comment in relation to the use of an OTN within a corporation	<p>We suggest that the Bill be amended to simplify accounting between related companies, along the lines of the GST legislation, whereby companies can register as a Group.</p>
8	1	165 – Objects	<p>Chevron submits that the objects under Clauses 165(b) and (c) should be amended to replace the words "reduce the incentives for such an activity to be located in, or relocated to, foreign countries ..." with "remove the incentives ..." as follows:</p>

			<p>The objects of this Part are:</p> <p>(a) to enable the identification of activities as emissions-intensive trade-exposed activities; and</p> <p>(b) to remove any incentive through the introduction of the CPRS for such an activity to be located in, or re-located to, foreign countries.</p> <p>until such time as is no longer warranted, having ...</p>
8	1-3	165 - 173	<p>It is proposed that the treatment of emissions intensive trade exposed industry be dealt with by regulation and the draft Bill is therefore silent on these matters.</p> <p>Given the significance of this element of the CPRS, the Bill should explicitly cover these arrangements with only matters of procedural detail to be left for the regulations.</p> <p>For example Part 8 dealing with emissions-intensive trade exposed industry should contain a similar level of detail as is provided in Parts 9 and 10 of the draft Bill regarding coal fired power generation and reforestation projects.</p>
12		General comment in relation to the level of detailed information to be published	<p>Chevron supports the timely publication of material so as to ensure the emissions trading market remains well informed as to the current and future scarcity of emission permits. Accordingly the publication of information under the CPRS should be restricted to matters such as the scheme caps and gateways, the number of permits auctioned and at what clearing price, the number of permits administratively allocated, information about how many permits have been banked and borrowed, how many have been voluntarily surrendered and how many permits have been imported into Australia.</p> <p>However, the Bill should not require the publication of information relating to specific commercial transactions as this does not support the purpose of the Bill and would create an additional administrative burden for no benefit.</p>
25	4	360 – Appointment of expert advisory committee members	<p>Chevron is concerned that the prohibition contained in Clause 360 on the appointment to an expert advisory committee of a person employed by a liable entity is so broad as to prevent effective expert representation on these committees.</p> <p>Consideration could be given to managing any real or perceived conflicts of interest through amendment to the provisions regulating membership of an expert advisory committee in Clauses 364 -370.</p>

Consequential Amendments Bill			
Schedule	Part/s	Item/s	Comment
1	1	General comment in relation to the Australian Securities and Investment Commission Act 2001	Requiring firms with a scheme liability to either hold a financial service licence or to use an intermediary in order to fulfil their obligations under the CPRS creates an additional and unwarranted regulatory burden.

## General comments

### Matters not addressed in the draft Bills

#### ***Ensuring emissions cost are passed on in the domestic economy***

A well designed, market-based, emission reduction scheme will ensure that the cost of carbon will be reflected in the price to the end user of a product or service. We note that in the energy supply market there are likely to be contractual impediments to passing on these costs. In particular long term domestic energy supply contracts which were entered into well in advance of the adoption of the carbon pollution reduction scheme and do not provide for review on the basis of increased carbon costs.

We suggest that the transitional provisions could seek to address this issue by including provisions which would facilitate the review and renegotiation of these contracts.

#### ***Differentiation between the national emissions commitment and the scheme cap***

The Bills do not provide for a transparent process to determine the allocation of the national emissions commitment between the CPRS scheme cap and the sectors of the Australian economy not covered by the CPRS.

#### ***The auction framework***

The Bills are silent on the design and function of the auction process by which the government proposes to allocate a significant portion of emissions permits. Greater clarity on the auction process should be included in the Bills.

#### ***Prohibition on the export of emissions units***

The White Paper proposed the introduction of a prohibition on the export of Australian emissions units. However, it is not clear from the draft Bills how the prohibition is proposed to be implemented.

Chevron opposes a prohibition on the export of Australian emissions units.

#### ***Rationalisation of existing climate change policies***

To maximise the economic and environmental efficiency of the CPRS it the large number of the existing policy instruments used to prescriptively regulate greenhouse emissions should be removed.

Please return **by 5pm (AEST) on 14 April 2009** to:

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