



Emissions Reduction Fund Green Paper: December 2013

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KEY POINTS

GENERAL

- APPEA supports a national climate change policy that delivers abatement at least cost.
- Reliable, secure and competitively priced energy is crucial to our everyday lives in Australia. Oil and gas plays a key role in meeting many of our energy needs.
- It is vital that Australia's national climate change policy approach, and therefore the design of the Emissions Reduction Fund (ERF), reflects the enormous economic and greenhouse benefit that can flow from a prosperous, vibrant and growing upstream oil and gas industry.
- The major challenge to the industry's continued growth is maintaining Australia's international competitiveness in the face of growing global competition. A high-cost local environment and the emergence of new LNG competitors has increased the level of competition Australia faces as it seeks to win market share and attract investment.
- Australia's national approach to climate change policy is a critical area of policy reform. The ERF should aim to enhance Australia's international competitiveness as a destination for oil and gas investments. It should not add to the cost burden facing the industry.
- The ERF should form a stable and durable foundation for Australia's national climate change policy approach. APPEA does not wish to see a return to the costly hotch-potch of State and Territory as well as national climate change approaches that has historically characterised many aspects Australia's greenhouse policy response.

DESIGN PRINCIPLES AND SOURCES OF EMISSIONS REDUCTIONS

- A variety of low cost, large scale abatement opportunities may come forward from the oil and gas industry, particularly if the ERF is designed with streamlined, efficient and effective administrative, reporting and compliance arrangements.
- The exact nature of the projects to come forward under the ERF is, however, a matter that will largely be a commercial decision for member companies and will be revealed through the auction process.
- The nature and focus of the Review proposed for late 2015 will be important. With the Green Paper proposing certain aspects of the ERF to commence in July 2014 and other aspects (a number of which are of particular importance to the upstream oil and gas industry) proposed to commence in July 2015, the ERF as a whole will only have been in operation for a very short time in late 2015. To ensure a full review of the operations of all aspects of the ERF is conducted drawing on experience and lessons learned, the review should be deferred until mid-2016. Any review should be conducted by the Productivity Commission. Any changes to the scheme arising from the review should only be made after extensive consultation with all relevant stakeholders.

SAFEGUARDING EMISSIONS REDUCTIONS

- The design and operation of a safeguard mechanism is an issue of critical importance to APPEA and its members.
- As the Government has made clear, the mechanism only applies to emissions above 'business as usual' and is not a mechanism to be used to raise revenue to provide funding for the ERF.
- It is vital that the safeguard mechanism not impose costs on Australian industry that are not faced by our international competitors or inhibit industry growth.
- APPEA supports the proposal to develop the framework for the safeguard mechanism approach over the period to 1 July 2015. The development of the mechanism is potentially one of the ERF's most complicated features. Taking the time required to consult with stakeholders to



develop an appropriate mechanism will be an important way to ensure ERF is established as the fundamental and durable policy basis of Australia's national climate change policy approach.

- In APPEA's submission the safeguard mechanism should reflect the following key principles:

1. Broad coverage

- Coverage of the mechanism should be as broad as possible. In particular, coverage should not be limited to existing National Greenhouse and Energy Reporting system (NGERs) reporters but should apply to emissions across the Australian economy, including those industries/sectors that do not currently report under NGERs.

2. How 'business as usual' is defined and applied in the context of individual facilities

- There is ambiguity around the use of the term business as usual in the Green Paper and this ambiguity complicates many aspects of the baseline setting process. In the case of LNG, for example, the 'business as usual' for the industry is one of significant growth and this should be reflected in the approach taken to setting emissions thresholds.

3. Set emissions thresholds at a facility level

- Emissions thresholds should be set at a NGERs facility level (or an appropriate aggregation of NGER defined facilities) consistent with the approach taken under NGERs and each project should have an emissions threshold set individually.

4. Determine an efficient methodology for setting emissions thresholds

- There are a variety of ways in which an emissions threshold for each NGER facility could be established. APPEA does not have a preferred model at this stage but looks forward to working with the Department to develop a potential model that would be appropriate for the oil and gas industry. Very importantly, such an approach will need to accommodate the year-to-year variability in emissions at a facility and will require a process that could be simply and automatically applied each year.

5. Allow absolute emissions or emissions intensity

6. Apply emissions thresholds based on operating experience

- The use of a 'best practice' approach is not appropriate for new facilities and APPEA recommends the Government work with industry to develop alternative and more appropriate approaches.
- Rather than a 'best practice' approach for a new NGERs facility, a new facility could have an emissions threshold applied after data from an appropriate number of years of production since start-up are available.

7. The safeguard mechanism

- The safeguard mechanism should be consistent with the Government's stated objective of applying it only to emissions above business as usual and not as a mechanism for raising revenue.
 - The focus on flexible compliance options set out in the Green Paper is sound. APPEA also supports the option of an initial transition period during which compliance action for exceeding baselines would not apply. Five years is an appropriate transition period.
- Following the transition period, an appropriately flexible mechanism could be applied through the following process:
 - The Regulator to notify the facility operator that it appears its emissions are above the facility's emissions threshold and ask the facility operator to explain the increase.
 - If no "reasonable explanation" is provided, the facility operator is asked to demonstrate how it intends to restore the facility's emissions to historical levels within a reasonable period of time.



- If the facility operator fails to demonstrate how it intends to reduce the facilities emission to within historical levels, the facility operator should be given the opportunity to reduce emissions via the purchase of credible offsets to or pay an excess emissions threshold charge.
- Rights to appeal any finding of the Regulator with respect to the provision of “reasonable explanation” or the imposition of an excess emissions threshold charge should be included in any legislation.

CREDITING EMISSIONS REDUCTIONS

- The Fund should have as wide as is possible coverage of emission sources and emission reduction opportunities, be open to a variety of commercial structures and project development approaches and be open to co-funding arrangements. It should allow for the different nature of bids that may come forward:
 - Specific ‘projects’ that may be bid into the ERF; and
 - Emissions reductions achieved below the ‘emissions threshold’ through year-to-year reductions at facilities.
- APPEA welcomes the Green Paper’s proposal that specific project types of emissions reduction opportunities be the key area of focus in ERF development, with proposals of this kind able to be bid into the Fund from 1 July 2014. The development of emissions threshold types of emissions reduction opportunities can proceed on a slightly longer timeframe and, following consultation with industry, commence on 1 July 2015.
- With a national greenhouse policy approach in place, any additional measures targeted at reducing greenhouse gas emissions should only apply to sectors of the economy that are not covered by a single national approach. With the planned commencement of the ERF from 1 July 2014, a comprehensive rationalisation of greenhouse measures across all Australian jurisdictions should be undertaken.
- Key amongst the policy approaches requiring rigorous assessment and streamlining are greenhouse conditions in environmental approval conditions, the Energy Efficiency Opportunities measure and the Renewable Energy Target.

PURCHASING EMISSIONS REDUCTIONS

- A number of auction model arrangements are possible and we do not have a preferred option at this stage of the ERF’s development. The ultimate auction model should be developed in consultation with stakeholders and be subject to rigorous testing (including a pilot) before the first ERF auction process is conducted.
- Specifying a contract period as short as five years is inappropriate and would act as a significant barrier to entry for a range of more capital-intensive abatement opportunities, many of which may be large-scale and involve the reduction of significant amounts of greenhouse gas emissions. It is also inconsistent with the design principles set out on the Green Paper, particularly the ‘streamlined administration’ principle. Limiting contract duration to five years will not make it easy for businesses to participate. The Fund should not feature a maximum contract duration. The duration of contracts should be a matter agreed between the Clean Energy Regulator and successful Fund participants.
- The ERF should not feature a ‘make good’ provision. An appropriately applied prequalification process would remove the need for ‘make good’ provisions. Having both a prequalification process and a ‘make good’ provision would inappropriately weight commercial risks towards ERF participants and is likely to add as a barrier to bidding into the Fund and therefore both lower participation in bidding rounds and inefficiently increase the clearing price required in an individual bidding round.



CARBON FARMING INITIATIVE

- Whichever methodologies are used to underpin the ERF, including any that are built from the existing Carbon Farming Initiative (CFI) process, must be underpinned by streamlined, efficient and effective administrative, reporting and compliance arrangements. Significant administrative streamlining will be required to the CFI to facilitate the development of abatement projects.
- Existing greenhouse gas abatement investments that are or would be eligible to generate Australian Carbon Credit Units (ACCUs) under the existing CFI rules should continue to be eligible to generate ACCUs that can be sold under the ERF.

ADMINISTRATION

- APPEA supports the continuation of the Clean Energy Regulator with responsibility for administration of the ERF. The Government should establish and fund an ongoing Advisory Board to advise on ERF governance and administrative arrangements.
- As with the CFI, administrative streamlining will be required to NGERs to facilitate the development of a diverse and 'deep' range of emissions reduction opportunities under the ERF.
- The Government should commission from the Department of the Environment and the Clean Energy Regulator a separate review of the NGER Act and associated reporting obligations. This review should have as one of its core purposes a significant simplification of current reporting obligations, consistent with the Government's overall red tape and green tape reduction programme.

CONCLUSIONS/NEXT STEPS

- APPEA looks forward to ongoing consultation with the Government and the Department as the ERF is further developed, ahead of the release of the ERF White Paper later in 2014.
- In particular, we believe there should be detailed consultation on the proposed legislative provisions to implement the ERF, the further development of the safeguard mechanism and the further development of facility methods. There should be detailed 'road testing' and 'stress testing' of the administrative provisions that will ultimately need to be developed to implement the ERF.



INTRODUCTION

Since 1959, the Australian Petroleum Production & Exploration Association (APPEA) has been the peak national body representing the upstream oil and gas exploration and production industry. APPEA has more than 85 member companies that explore for and produce Australia's oil and gas. In addition, APPEA's more than 220 associate member companies provide a wide range of goods and services to industry. Further information about APPEA can be found on our website, at www.appea.com.au.

APPEA has been engaged in the greenhouse policy debate since its inception and has participated in every major consideration of national climate change policy approaches in Australia. APPEA welcomes the opportunity to provide input on the Emissions Reduction Fund (ERF) Green Paper as part of its ongoing engagement with the Government on the development of a long-term, sustainable, national climate change policy. This submission follows our submission¹ on the ERF Terms of Reference, lodged on 18 November 2013.

Most importantly, APPEA supports a national climate change policy that delivers abatement at least cost.

APPEA is also a member of the Australian Industry Greenhouse Network (AIGN), a network of industry associations and individual businesses that contribute to the climate change policy debate and see value in joint industry action on climate change policy issues in order to promote sustainable industry development². APPEA has contributed to the AIGN submission on the ERF Green Paper.

THE AUSTRALIAN UPSTREAM OIL AND GAS INDUSTRY

The ERF Green Paper should be seen within the context of the current state and potential future contribution of the upstream oil and gas industry to the Australian economy and to the welfare of all Australians. Reliable, secure and competitively priced energy is crucial to our everyday lives in Australia. Within this framework, oil and gas plays a key role in meeting many of our energy needs.

Australia has vast resources of natural gas. Geoscience Australia³ has estimated that Australia has over 819 trillion cubic feet (tcf) (900,540 petajoules) of natural gas resources. By way of comparison, Australia's production of natural gas in 2011-12 was around 2 tcf (2,200 petajoules), meaning Australia has more than enough gas to service both domestic and export markets for decades.

Our abundant natural gas resources, in particular, place Australia in an enviable position to maintain long-term, cleaner energy security domestically and internationally. Natural gas makes it

¹ Available at www.environment.gov.au/submissions/emissions-reduction/tor/226-australian-petroleum-production-and-exploration-association.pdf.

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

³ Geoscience Australia (2012), *Australian Gas Resource Assessment 2012*, 14 May (available at www.ga.gov.au/products/servlet/controller?event=GEOCAT_DETAILS&catno=74032).

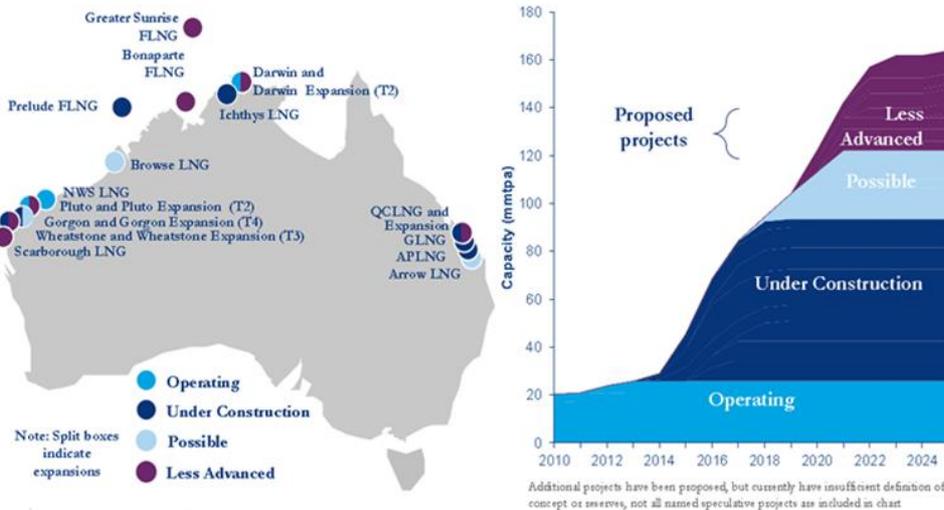


possible for Australia to meet the world's growing energy needs over the coming decades while incorporating a strategy to curb emissions and address the risk of climate change.

Just as importantly, the industry creates significant wealth for the country, including through the employment of many Australians, underpinning the revenue collections of governments and generating valuable export revenue for the Australian economy. Almost \$200 billion is currently being invested in oil and gas projects including seven major liquefied natural gas (LNG) export projects⁴.

According to economic modelling commissioned by APPEA and conducted by Deloitte Access Economics⁵, this will increase Australian GDP by up to 2.2 per cent a year and over the investment phase, will create about 103,000 (full-time equivalent) jobs across the Australian economy. Companies all over Australia are supply goods and services to the oil and gas industry, and the use of fly-in, fly-out staffing is spreading the benefits of the industry across Australia. Figure 1 provides an overview of Australia's LNG projects.

Figure 1. Australian LNG projects: by liquefaction status



Source: Wood Mackenzie LNG Tool, August 2012.

By 2020, according to Deloitte Access Economics modelling, the sector's economic contribution to the national economy is projected to more than double to \$65 billion and taxation paid will rise from \$8.8 billion (\$4.9 billion in corporate taxes and \$3.8 billion in production taxes) to reach almost \$13 billion.

⁴ See Bureau of Resources and Energy Economics (2013), *Resources and Energy Major Projects*, for a listing of upstream oil and gas projects at the Publicly Announced Stage, Feasibility Stage, Committed Stage and Completed Stage (available at www.bree.gov.au/publications/resources-and-energy-major-projects).

⁵ See Deloitte Access Economics (2012), *Advancing Australia: Harnessing our comparative energy advantage*, 25 June (available at www.appea.com.au/wp-content/uploads/2013/04/120625_DAEreportAPPEAfinal.pdf).



While the Australian economy has benefited and will continue to benefit significantly from LNG investments committed in the past, there are even more projects under consideration, representing a potential additional investment exceeding \$180 billion. Realising these would benefit the entire nation. Analysis by McKinsey & Co⁶ shows GDP would increase by 1.5 per cent, about 150,000 jobs would be created across the Australian economy, and tax revenues created equivalent to nearly half the total federal debt. The benefits of improving productivity would also flow to other sectors.

It is vital that Australia's national climate change policy approach, and the central role the ERF will play in that approach, recognises the enormous economic and (as is considered below) greenhouse benefit that can flow from a prosperous and vibrant upstream oil and gas industry.

THE ROLE OF NATURAL GAS

Greater use of Australian natural gas – in the domestic market, and in Asia as LNG exports – can significantly reduce greenhouse gas emissions.

THE IMPORTANCE OF NATURAL GAS AS A LOW GREENHOUSE GAS EMISSIONS ENERGY SOURCE IN AUSTRALIA

Australia could generate significant additional national economic, environmental and social benefits through greater utilisation of its substantial natural gas resources.

Using more natural gas in Australia's power generation and resource processing would significantly enhance the nation's ability to meet increasing energy needs while at the same time reducing greenhouse gas emissions.

These outcomes are possible because currently available natural gas technologies produce only 30 to 50 per cent of the emissions produced by current coal technologies in generating electricity.

According to the Commonwealth Scientific and Industrial Research Organisation (CSIRO) (and a range of energy industry analysts), current generation coal-fired power stations produce between 0.8 and 1.2 tonnes of carbon dioxide equivalent greenhouse gas emissions (CO₂-e) per megawatt hour (MWh) of generation while a combined cycle gas turbine power station produces only around 0.35 to 0.36 tonnes CO₂-e/MWh⁷.

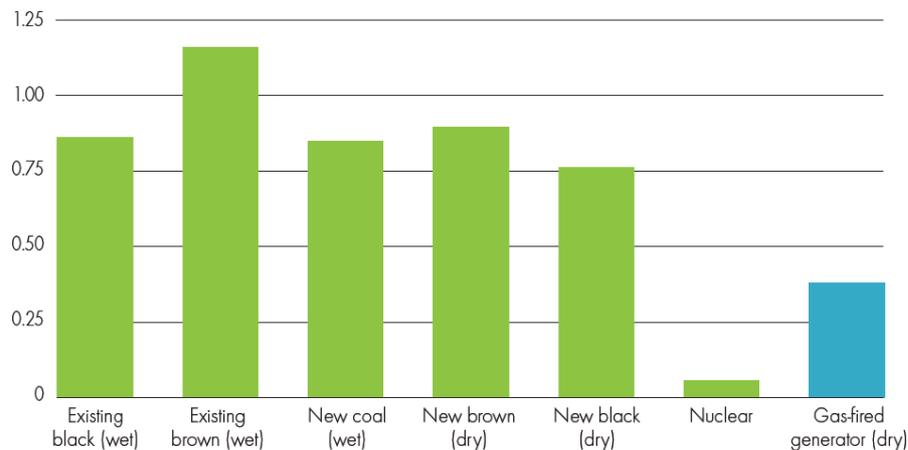
This is illustrated in Figure 2, which shows the significantly lower greenhouse gas emission associated with the gas-fired electrical power generation compared to the use of other conventional fuels.

⁶ McKinsey & Co (2013), *Extending the LNG boom: Improving Australian LNG productivity and competitiveness*, 28 May (available at www.mckinsey.com/global_locations/pacific/australia/en/latest_thinking/extending_the_lng_boom).

⁷ Energy Futures Forum (2006), *The Heat is on: the future of energy in Australia*, December (see www.csiro.au/Organisation-Structure/Flagships/Energy-Flagship/Energy-Futures-Forum.aspx for further details).



Figure 2. Emissions intensity of various fuel types for electricity generation (tonnes CO₂-e/MWh)



Sources: ACIL Tasman, Company websites/reports, McLennan Magasanik Associates, ROAM Consulting (2009).

Natural gas provides one of the lowest cost means by which Australia can reduce greenhouse gas emissions in the electrical power generation sector, both through increased use of existing gas-fired power stations and new gas-fired power stations.

Natural gas is also an important safeguard for intermittent renewable energy sources. For example, modelling done by South Australia's Electricity Supply Planning Council notes that every 5,000MW of wind power generation requires around 2,100MW of gas-fired power generation to ensure that a reliable supply of electricity is available to the grid⁸.

The increased use of natural gas also has several additional environmental benefits, such as:

- Reduced emissions of particulates.
- Reduced emissions of sulfur dioxide (an important contributor to smog⁹ and acid rain).
- Significantly lower demand for water for power station cooling.

Much greater use of Australia's extensive gas resources will be crucial in meeting the challenge of significantly reducing global greenhouse gas emissions at lowest possible cost whilst enhancing Australia's economic and export performance.

THE IMPORTANCE OF NATURAL GAS AS A LOW GREENHOUSE GAS EMISSIONS ENERGY SOURCE IN ASIA

Australia's LNG industry is in a unique position to contribute substantially to the economic development of the nation and reduce global greenhouse gas emissions. Australia's vast resources

⁸ Electricity Supply Industry Planning Council (2008), *Submission to AEMC Review of Energy Market Frameworks in Light of Climate Change Policies*, November (available at www.aemc.gov.au/Media/docs/Electricity%20Supply%20Industry%20Planning%20Council-51706fed-d681-4e3a-ba64-de54e8de7176-0.PDF).

⁹ Fine secondary particles are formed by the oxidation of sulfur oxides.



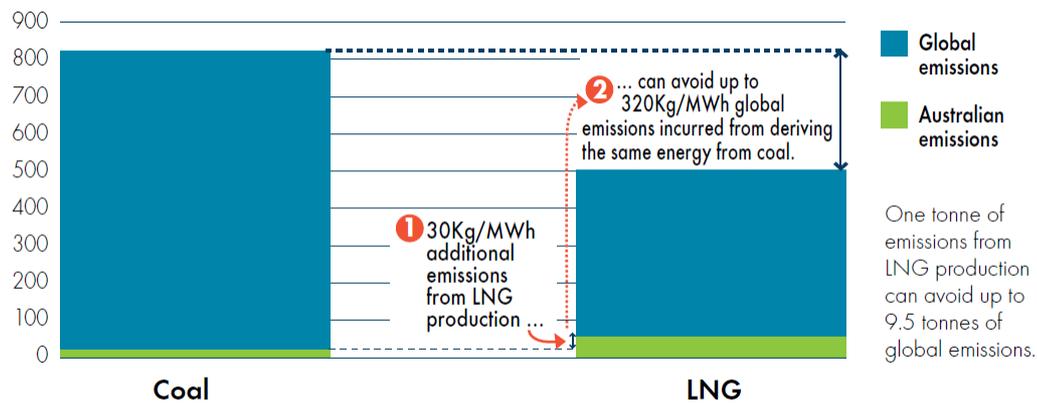
of natural gas and proximity to growing markets make us well-placed to meet the global climate change challenge while substantially contributing to Australia's economic growth.

A 2008 study by WorleyParsons¹⁰, for example, compares lifecycle greenhouse gas emissions of Australian LNG exports from the North West Shelf Project with Australian east coast black coal exports in terms of lifecycle greenhouse gas emissions: from extraction and processing in Australia through to an end use of combustion (using different power generation technologies) in China for power generation.

Figure 3 below is derived from data within the study, and shows that:

- For every tonne of CO₂-e emitted in LNG production within Australia, between 5.5 and 9.5 tonnes of emissions from the coal alternative can be avoided globally.
- LNG has a substantially lower greenhouse footprint associated with it compared to coal – not just in combustion emissions, but throughout its lifecycle.
- The lifecycle greenhouse intensity for LNG is about 50 per cent lower than that of coal.

Figure 3: Displacement of coal by LNG (kg/MWh CO₂-e by fuel source)



Source: Derived from data in WorleyParsons (2008; 2011).

A similar 2011 WorleyParsons study¹¹ compared lifecycle greenhouse gas emissions of Australian LNG projects from Queensland using natural gas from coal seams as the fuel source with Australian east coast black coal exports. The analysis considered lifecycle greenhouse gas emissions: from extraction and processing in Australia through to an end use of combustion (using different power generation technologies) in China for power generation.

It found that, in the case of Queensland-based LNG exports:

¹⁰ WorleyParsons (2008; 2011), *Greenhouse Gas Emissions Study of Australian LNG*, originally prepared August 2008; updated for public release, March 2011 (available at www.woodside.com.au/Our-Approach/Climate-Change/Pages/Benefits-of-LNG.aspx).

¹¹ WorleyParsons (2011), *Greenhouse Gas Emissions Study of Australian CSG to LNG*, April 2011 (available at www.appea.com.au/images/stories/steve_files/appea%20csg%20greenhouse%20gas%20emissions%20study%20executive%20summary.pdf).



- For every tonne of CO₂-e emitted in LNG production within Australia, between 2.5 and 4.3 tonnes of emissions from the coal alternative can be avoided globally.
- Considering savings from a 30 year 10 million tonnes per year (Mtpa) Queensland onshore gas LNG project, if this gas is combusted in a combined cycle gas turbine (CCGT) plant instead of coal in a subcritical coal plant, the life cycle emissions are 42.7 Mt CO₂-e per year, the annual savings 37.2 Mt CO₂-e and the project life savings 1,114 Mt CO₂-e¹². For combustion in a CCGT plant instead of a supercritical coal plant the annual savings and project life savings are 21.7 Mt CO₂-e and 652 Mt CO₂-e respectively.

There are significant benefits to Australia and international economies from the greater use of gas as a lower greenhouse gas emitting energy source.

NATURAL GAS AND REDUCING GREENHOUSE GAS EMISSIONS: THE EXPERIENCE OF THE UNITED STATES

Clear evidence of the greenhouse-related benefits arising from the greater use of natural gas in power generation is provided by the recent experience of the United States.

Recent US Energy Information Agency (EIA) data shows that – largely as a result of a shift from coal to natural gas for power generation – US carbon dioxide emissions declined by more than 700 Mt in 2012, 12 per cent lower than the peak in 2007. The EIA also announced that energy-related carbon dioxide emissions in the US fell 3.8 per cent in 2012, to their lowest level since 1994¹³.

In reporting these findings, the EIA noted:

*The **increase in natural gas-fired generation**, while coal-fired generation decreased, substantially **reduced the carbon intensity** of electricity generation in 2012. [Emphasis added]*

INTERNATIONAL COMPETITIVENESS: THE MAJOR CHALLENGE

The major challenge to the industry's continued growth is maintaining Australia's international competitiveness in the face of growing global competition. A high-cost local environment and the emergence of new LNG competitors in East Africa, North America and other locations has increased the level of competition Australia faces as it seeks to win market share and attract investment.

We believe that the industry and governments must do everything possible to ensure the \$200 billion in projects under construction commence production in a timely manner and that Australia secures future oil and gas investment to supply to domestic and international needs.

Some factors affecting current and future investment, such as the high Australian dollar, are beyond the ability of industry to influence. However, other key challenges must be addressed. In

¹² This compares to total Australian annual emissions (over the year ended September 2013) of 542 Mt CO₂-e (see www.environment.gov.au/node/35323).

¹³ US Energy Information Administration (2013), *U.S. Energy-Related Carbon Dioxide Emissions, 2012*, October (see www.eia.gov/environment/emissions/carbon).



particular, the industry and its suppliers need to work harder at constraining cost growth and to meeting skilled labour requirements while government focuses on streamlining policy and reducing green and red tape. Industry is investing in technology and reducing costs.

There are also critical policy areas that require genuine reform. Australia's national approach to climate change policy is one of those critical areas. The development of the ERF should be aimed at enhancing Australia's international competitiveness as a destination for oil and gas investments. It should not add to the cost burden facing the industry.

GENERAL COMMENTS ON THE EMISSIONS REDUCTION FUND GREEN PAPER

Australia has substantial natural gas resources and developing these resources for domestic use as well as export can provide significant national economic and social benefits. The relatively low-cost emissions abatement opportunity offered by the increased use of natural gas means that developing these resources can also deliver significant environmental benefits.

In order to realise these benefits, APPEA will continue working with the Australian Government through the development of the ERF (and associated Direct Action Plan initiatives) to:

- Support a long-term sustainable national climate change policy response. Oil and gas projects are generally long-term – often 30-40 years or more. Policy stability (including in Australia's climate change policy response) is therefore very important.
- Support market conditions that allow the efficient use of natural gas for electrical power generation and in direct applications in the domestic economy, for example in resource processing. This will lower the emissions intensity of Australia's electricity supply sector and have a consequent reduction in the emissions intensity of resource processing.
- Increase the export of Australian LNG to help Australia's Asian trading partners lower their greenhouse gas emissions, thereby contributing to a potential significant reduction in global emission compared to the use of higher emitting fuels.

The ERF should be the fundamental and durable policy basis of Australia's national climate change policy approach. We cannot afford a return to the costly hotch-potch of State and Territory as well as national climate change approaches that has historically characterised many aspects of Australia's greenhouse policy response.

If the ERF is to form the basis of Australia's national response, it should be accompanied by a programme across all governments to remove the red tape and regulatory burden imposed by other greenhouse (or greenhouse-related) programmes and policies across every Australian jurisdiction.

This will also require a longer-term funding commitment from the Government, to fund the ERF beyond the Federal Budget's 'forward estimates' period to provide the necessary investment and policy stability required to underpin low cost large scale emissions reduction opportunities, a number of which may operate for many years.

SPECIFIC COMMENTS ON THE EMISSIONS REDUCTION FUND GREEN PAPER

APPEA offers the following comments on those aspects of the ERF Green Paper of most interest/relevance to the Australian upstream oil and gas industry.



DESIGN PRINCIPLES AND SOURCES OF EMISSIONS REDUCTIONS

APPEA supports a national climate change policy that delivers abatement at least cost. This means APPEA supports the ERF being designed, as is set out on page 2 of the Green Paper, to

... achieve lowest-cost emissions reductions as its primary objective.

Opportunities for large-scale, low-cost emissions reductions, including estimates of potential reductions

A variety of low cost, large scale abatement opportunities may come forward from the oil and gas industry, particularly if the ERF design is designed with streamlined, efficient and effective administrative, reporting and compliance arrangements.

The exact nature of the projects to come forward under the ERF is, however, a matter that will largely be a commercial decision for member companies and will be revealed through the auction process. To facilitate projects coming forward under the ERF, the Fund should have as wide a possible coverage of emission sources and emission reduction opportunities. It should be open to a variety of commercial structures and project development approaches and be open to co-funding arrangements.

We note various studies¹⁴ have already been completed examining potential energy savings or emissions reduction opportunities within the upstream oil and gas industry. Our review of these studies shows that they are often based on inappropriate assumptions and the use of data collected for other purposes or data that has not been verified by the relevant industry. They do not appropriately measure energy savings or emissions reduction opportunities. In general, they have overestimated available opportunities, in many cases by underestimating the costs associated with implementing these opportunities or double-counting the opportunities that may be available. Some, particularly the Energy Efficiency Opportunities programme, have incorrectly claimed savings reported to programme as having been motivated by it. This issue is considered further below.

In our view, the Government should not use data from these studies as a basis for policy development. This includes the ClimateWorks studies and references to the Energy Efficiency Opportunities programme, set out on pages 12-14 of the Green Paper.

The Government will conduct a review of the Emissions Reduction Fund towards the end of 2015 to provide certainty about the policy and design post-2020

The nature and focus of the Review proposed for late 2015 will be important. With the Green Paper proposing aspects of the ERF should commence in July 2014 and other aspects (a number of which are of particular importance to the upstream oil and gas industry) proposed to commence in July 2015, the ERF as a whole will only have been in operation for a very short time in late 2015. It may be difficult to conduct a review of its full operation with only a very short amount of time to

¹⁴ For example, the recent Industrial Energy Efficiency Data Analysis Project by ClimateWorks and the former Department of Resources, Energy and Tourism (see www.climateworksaustralia.org/project/current/industrial-energy-efficiency-data-analysis). The shortcomings identified with this analysis have resulted in the removal of the draft reports relating to oil and gas.



draw lessons and experience for the operation of the Fund. While the aspects of the ERF that commence in July 2014 will have been operating for over a year by late 2015, it may be challenging to usefully draw lessons from these aspects of the Fund separate from the aspects commencing in July 2015. In general, a review of the ERF this early in its existence, before it has had many years of stable operational experience, may be of limited value.

To ensure a full review of the operations of all aspects of the ERF is conducted drawing on experience and lessons learned, the review should be deferred until mid-2016. Any review should be conducted by the Productivity Commission. Any changes to the scheme arising from the review should only be made after extensive consultation with all relevant stakeholders.

SAFEGUARDING EMISSIONS REDUCTIONS

The design and operation of a safeguard mechanism (applying to emissions above an emissions threshold¹⁵) is an issue of critical importance to APPEA and its members.

The Government's stated objective is set out on page 38 of the Green Paper as:

The Government has a clear objective not to raise revenue from these elements of the Emissions Reduction Fund and it is not anticipating any revenue.

Consistent with this intention, in the event that an entity did exceed its baseline, there would be flexible compliance arrangements available.

APPEA supports this approach. As the Government has made clear, the mechanism only applies to emissions above business as usual and is not a mechanism to be used to raise revenue to provide funding for the ERF. It is vital that the safeguard mechanism not impose costs on Australian industry that are not faced by our international competitors.

Set out below are a number of issues that will require further consideration as this safeguard mechanism is developed in the White Paper and legislative framework together with some recommendations (following on from our ERF ToR recommendations) on possible approaches.

APPEA supports the Green Paper's proposal, set out on page 35, to develop the framework for the safeguard mechanism approach over the period to 1 July 2015. The development of the mechanism is potentially one of the ERF's most complicated features. Taking the time required to consult with stakeholders to develop an appropriate mechanism will be an important way to ensure ERF is established as the fundamental and durable policy basis of Australia's national climate change policy approach.

Coverage of the mechanism

Coverage of the mechanism should be as broad as possible. In particular, coverage should not be limited to existing NGERs reporters but should apply to emissions across the Australian economy,

¹⁵ APPEA recommends use of the term "emissions threshold" rather than "baseline" – emissions threshold is a more appropriate term fitting the policy intent of this aspect of the ERF.



including in those industries/sectors that do not currently report under NGERs. APPEA does, however, support the retention of a minimum emissions thresholds, such as the 25,000 tonnes CO₂-e threshold that exists under the current Act.

How baselines could most easily be set to effectively limit increases in historical business-as-usual emissions

The setting of activity definitions under the previous Government's approach was a contentious and unsatisfactory process and produced outcomes with which the industry continues to disagree. An example was the definition of 'LNG production' under the Jobs and Competitiveness Program (JCP). The definition was too narrow, focussing on the liquefaction plant only, rather than the whole of the LNG production process.

How 'business as usual' is defined and applied in the context of individual facilities

There is ambiguity around the use of the term business as usual in the Green Paper and this ambiguity complicates many aspects of the baseline setting process discussed in the Green Paper and considered below.

In the case of LNG, for example, the industry is currently investing \$200 billion in projects that will see its overall production levels rise from 24 Mtpa in 2012-13 to around 89 Mtpa by 2020. The 'business as usual' for the industry is therefore one of significant growth in production and exports. This needs to be reflected in the approach taken to setting emissions thresholds.

In addition, the way in which emissions thresholds in the industry may change over time will need to be taken into account. For example, some of the factors that determine the emissions intensity of a project over time are outside the control of the project proponents.

Amongst other things, the level of impurities in the gas field and the carbon dioxide levels in particular gas fields many change over the life of the project, and generally deteriorate, rather than improve.

In addition, the way in which emissions thresholds in the industry may change over time will need to be taken into account. For example, some of the factors that determine the emissions intensity of a project over time are outside the control of the project proponents. Among other things, the level of impurities in the gas field and the carbon dioxide levels in particular gas fields may change over the life of the project, and generally deteriorate, meaning emissions increase, rather than improve. This can see the emissions intensity of an oil and gas project increase over time, for reasons, as noted above, outside the control of the project proponents. This means that while new investments may be made in the most efficient, commercially viable technology available, for the reasons outlined above, it does not necessarily follow that the overall emissions profile of a new project will always be lower than existing projects.

The treatment of new entrants and significant expansions, including definitions of best practice (this issue also includes how baselines will be set for new projects that do not have five years' worth of NGERs data)

The use of a 'best practice' approach is not appropriate for new facilities and APPEA recommends the Government work with industry to develop alternative and more appropriate approaches.

As noted above, the setting of activity definitions under the JCP was a contentious and unsatisfactory process, and the industry is very keen to ensure that such a process is not repeated in the approach taken to this aspect of the ERF:



- For example, what is 'best practice' in the LNG industry is very difficult to determine. Even with the current growth in the industry, it remains the case that there are only a relatively small number of LNG projects around the world (and as a result, an even smaller number in Australia).
- Proposals to establish a baseline considering best practice will by definition involve value judgments and administrative discretion that in the past have been demonstrated to be complex to administer and apply consistently.
- While there is some commonality in the LNG, crude oil or domestic gas production facilities themselves, the differences in geology, distance from the field to the plant, field composition, ambient air temperature, customer requirements and the associated (in the case of LNG) specification of the regasification facility in the customer country and a range of other factors mean that most projects are 'bespoke' facilities designed to produce, for example, domestic gas and/or LNG from particular gas fields and deliver them to particular markets.

Key features for the design and operation of a safeguard mechanism

Given these issues and the need to ensure the process for establishing thresholds is as streamlined, efficient, administratively simple and sustainable as possible, the design and operation of a safeguard mechanism should have the following key features:

1. Set emissions thresholds at a facility level

Emissions thresholds should be set at a NGERs facility level (or an appropriate aggregation of NGER defined facilities) consistent with the approach taken under NGERs and each project (LNG, domestic gas, liquids, and so on) should have an emissions threshold set individually:

- NGERs is underpinned by facility level reporting:
 - Given the bespoke nature of oil and gas processing facilities due to external factors an emissions threshold baseline set at an industry level is inequitable, creating 'winners' and 'losers' within that industry.
 - An emissions thresholds set at a company/firm/corporation level will be problematic to administer as companies grow, divest, merge and so on.
 - There will also need to be a process for adjusting emissions thresholds for major existing (brownfields) projects and for those companies who have broadly defined 'facilities' under NGERs (for example, vertically integrated production processes).

2. Determine an efficient methodology for setting emissions thresholds

There are a variety of ways in which an emissions threshold for a NGERs facility could be established. APPEA does not have a preferred model at this stage but looks forward to working with the Department during the period to July 2015 to develop a model that would be appropriate for the oil and gas industry. Whichever methodology is chosen, it would need to accommodate the year-to-year variability in emissions at a facility requiring a process that could be simply and automatically applied each year. The approach will also need to be designed in a manner that



ensures the emissions thresholds set through this approach do not discriminate against facilities that by their nature have increasing emissions intensity over time¹⁶ and allows new data to be simply and automatically incorporated into thresholds.

3. Allow absolute emissions or emissions intensity

Emissions thresholds could be set on an 'absolute emissions' basis or an 'emissions intensity' basis, as is appropriate for the facility. For example, an absolute emissions approach may be more appropriate for a facility that produces multiple products, while an emissions intensity approach (based on business as usual production) may be more appropriate for a facility that produces a single product.

Given this, it is appropriate that flexibility in determining thresholds be maintained for ERF participants and for those to whom the safeguard mechanism will apply.

4. Apply emissions thresholds based on operating experience

Rather than a 'best practice' approach for a new NGERs facility, a new facility could have an emissions threshold applied after data from an appropriate number of years of production since start-up¹⁷ are available (once the facility has been fully commissioned and is operating in a business as usual state).

During this period the facility operator would not have access to the ERF (in relation to that facility). The facility would also be required to measure itself against emissions forecasts to demonstrate that it is performing at or as close to design as possible.

5. The safeguard mechanism

As noted above, the Government's stated objective is set out on page 38 of the Green Paper as:

The Government has a clear objective not to raise revenue from these elements of the Emissions Reduction Fund and it is not anticipating any revenue.

Consistent with this intention, in the event that an entity did exceed its baseline, there would be flexible compliance arrangements available.

APPEA supports this approach. As the Government has made clear, the mechanism only applies to emissions above business as usual and is not a mechanism to be used to raise revenue to provide funding for the ERF.

The mechanism should not be referred to or called a penalty. A 'penalty' may imply a legal breach and many firms have internal controls that prevent them from knowingly doing anything that could incur such an inferred legal breach. Many commercial contracts do not allow 'penalty costs' to be passed through and this may cause contractual difficulties where it is appropriate for these costs to

¹⁶ For example, because of changes in the composition on the gas field over time that see a greater level of impurities and associated additional processing requirements later in the life of the field.

¹⁷ For example, five years' worth of operational data.



be passed. For example, this may have particular implications where the facility is operated on behalf of a joint venture as it will expose the facility operator to unreasonable risk if these costs cannot be met by the respective joint ventures.

APPEA welcomes the focus on flexible compliance options set out in the Green Paper. APPEA also supports the option set out on page 38 of an initial transition period during which compliance action for exceeding baselines would not apply. Five years is an appropriate transition period.

Following the transition period, an appropriately flexible mechanism could be applied through the following process:

- The Clean Energy Regulator to notify the facility operator that it appears its emissions are above the facility's emissions threshold and ask the facility operator to explain the increase, for example, has there been an increase in plant throughput, has the quality of facility inputs materially degraded, have there been any unusual process upsets that have increased emissions? If there is a "reasonable explanation"¹⁸ for the increase in emissions then no further action is taken.
- If no "reasonable explanation" is provided, the facility operator is asked to demonstrate how it intends to restore the facility's emissions to historical levels within a reasonable period of time.
- If the facility operator fails to demonstrate how it intends to reduce the facilities emission to within historical levels, the facility operator be given the opportunity to reduce emissions via the purchase of credible offsets to or pay an excess emissions threshold charge.
- Rights to appeal any finding of the regulator with respect to the provision of "reasonable explanation" or the imposition of an excess emissions threshold charge should be included in any legislation.

The emissions threshold charge could be set in a variety of ways but, in keeping with the Government's overall approach that emphasises incentives rather than penalties, it should be set at a low level. Access to all bona fide permits, including international permits, could be available to meet the emissions charge, noting that schemes do not need to be linked to achieve this. Such an approach could be developed in a manner consistent with the multi-year compliance period approach set out on page 38 of the Green Paper.

CREDITING EMISSIONS REDUCTIONS

Emissions reduction methods will be developed to calculate genuine and additional emissions reductions from new actions that are not mandatory and have not been paid for under another programme

As noted above, a variety of low cost, large scale abatement opportunities may come forward from the oil and gas industry, particularly if the ERF design is designed with streamlined, efficient and effective administrative, reporting and compliance arrangements.

¹⁸ With the meaning/criteria for what constitutes "reasonable justification" to be determined through further consultation.



The exact nature of the projects to come forward under the ERF is, however, a matter that will largely be a commercial decision for member companies and will be revealed through the auction process.

The ERF should allow for the different nature of bids that may come forward. This would include:

- Specific 'projects' that may be bid into the ERF [and which may or may not be reported through the existing infrastructure provided by the *National Greenhouse and Energy Reporting Act 2007* (NGER Act)].
- Reductions achieved below the 'emissions threshold' through year-to-year reductions – through operational improvements, for example – in emissions at existing facilities (as defined in the NGER Act).

Issues around each of these different types of bids are considered further below.

APPEA welcomes the Green Paper's proposal that specific project types of emissions reduction opportunities be the key area of focus in ERF development, with proposals of this kind able to be bid into the Fund from 1 July 2014. The development of emissions threshold types of emissions reduction opportunities can proceed on a slightly longer timeframe and, following consultation with industry, commence on 1 July 2015.

Complementary measures: a comprehensive streamlining of Australia's greenhouse policies and programmes

With a national greenhouse policy approach in place, any additional measures targeted at reducing greenhouse gas emissions should only apply to sectors of the economy that are not covered by single national approach. There is an urgent need to comprehensively streamline Australia's greenhouse policies and programmes. It is imperative that governments expedite the removal of the plethora of other policies and programmes regulating greenhouse gas emissions in Australia. The growth of separate greenhouse initiatives and their lack of consistency increases costs and uncertainty for Australian industry, including the upstream oil and gas industry.

With the planned commencement of the ERF from 1 July 2014, a comprehensive rationalisation of greenhouse measures across all Australian jurisdictions should be undertaken.

Key amongst the policy approaches requiring rigorous assessment and streamlining are:

- Greenhouse conditions in environmental approval conditions.
- The Energy Efficiency Opportunities measure.
- The Renewable Energy Target.

Greenhouse conditions in environmental approval conditions

The regulatory reform opportunities afforded by the introduction of the ERF include the removal of any greenhouse gas abatement requirements that may be imposed as part of environmental



approval processes. While a number of such requirements have been removed in recent years¹⁹, a number remain and, most concerning, have been raised with project proponents as a part of recent approval processes.

Conditions of this nature are fundamentally inconsistent with the introduction of the ERF and should be immediately removed. No greenhouse gas abatement conditions should be included in future environmental approvals.

Energy Efficiency Opportunities

APPEA member companies have in place long-standing and pervasive energy management policies, systems and measurement indicators that form a core part of their operational performance²⁰. The industry has also been a participant in numerous voluntary and mandatory energy efficiency and energy efficiency related programmes since such programmes commenced in Australia.

One of the features of these experiences has been a relative misunderstanding and under-appreciation by many of the existing and powerful drivers for energy efficiency that pervade the operations of the upstream oil and gas industry in Australia and the industry's history of reducing the energy intensity of its operations and increasing its energy production efficiency.

A clear example of these existing drivers can be found in the operations of Australia's domestic gas processing plants and existing and proposed export LNG plants, noting that the process of liquefying natural gas is particularly energy-intensive. The fuel used to power the various processes at the facility is often derived from the natural gas itself. Any gas used to serve as an energy source for the process is gas that cannot be liquefied and sold to export customers. This means that the use of natural gas as an energy source at the facility has a very direct opportunity cost associated with it – a unit of gas that can be saved through reducing energy use is a unit of gas that can be sold.

This driver, that pervades the initial design and ongoing operation of these facilities exists independent of any energy efficiency policy or programme and drives energy efficiency actions throughout the facility. Similar drivers exist for other upstream oil and gas facilities.

This includes programmes such as EEO (including, most importantly, the recent EEO extension to greenfields and major expansions) which should now be considered redundant. The EEO had been designed to encourage:

... large energy-using businesses to improve their energy efficiency. It does this by requiring businesses to identify, evaluate and report publicly on cost effective energy savings opportunities²¹

¹⁹ For example, the requirement for the Prelude Floating LNG Project to develop a "Greenhouse Gas Abatement Strategy" was removed in April 2013 (see www.environment.gov.au/epbc/notices/assessments/2008/4146/variation-2008-4146.pdf).

²⁰ An outline of these policies, processes and management systems were provided in a number of APPEA member company submissions to the Prime Minister's Task Group on Energy Efficiency, which reported in 2010. See ee.ret.gov.au/energy-efficiency/strategies-and-initiatives/prime-ministers-task-group-energy-efficiency for further information.

²¹ See www.energyefficiencyopportunities.gov.au for further information.



The ERF will provide an incentive (over and above existing drivers considered above) to identify, evaluate and, where cost effective, act on any energy efficiency opportunities. For energy producing companies, particularly those operating in the upstream oil and gas industry, EEO is additional, and not complementary, to a mechanism like the ERF.

EEO imposes a range of administrative and compliance costs on participants and these costs can, for each participant, approach \$500,000. In addition, the Department of Industry incurs administration costs for the EEO programme that total around \$8 million.

The *Mid-Year Economic and Fiscal Outlook* announced, at page 145, that the Government would be terminating funding for the Energy Efficiency Opportunities programme from 1 July 2014. APPEA has welcomed this announcement. While the announcement unfortunately leaves obligations in place for the compliance period ending 30 June 2014, it does provide a clear signal as to the future of the scheme and underlines the Government's desire to reduce the level of unnecessary regulatory burden on Australia industry.

With the commencement of the ERF and the end of funding for the current phase of the scheme, the Energy Efficiency Opportunities Assessment programme should be permanently discontinued and the *Energy Efficiency Opportunities Act 2006* should be repealed.

Renewable Energy Target

The role of the Renewable Energy Target (RET) which forces a fixed quantum of renewable energy into the electricity supply mix, displacing lower cost non-renewable, but relatively low-emission alternatives (most notably natural gas), should now be the subject of rigorous assessment. APPEA looks forward to engagement with the Review of the RET announced on 17 February 2014 by the Minister for the Environment, the Hon Greg Hunt MP and the Minister for Industry, the Hon Ian Macfarlane MP²².

Paradoxically, the RET will not result in any extra greenhouse gas emissions abatement, but will certainly result in extra costs as it locks in coal-fired power generation while driving the deployment of higher cost renewable technologies. It thus runs directly counter to the ERF's primary objective of achieving lowest cost emissions reductions.

The RET is an economically inefficient policy that should be discontinued. Based on economic modelling conducted by BAEconomics, the cost of continuing with the RET scheme when a national climate policy is in place²³ will reduce Australia's economic output (GDP) by \$6.5 billion more than would the standalone approach²⁴.

The RET should be discontinued. It is a policy that results in a higher cost to achieve the same level of overall constraint on greenhouse gas emissions than would have been achieved in the absence of the RET. If the RET is retained, its negative impact should be reduced:

²² See www.environment.gov.au/minister/hunt/2014/mr20140217.html or www.minister.industry.gov.au/ministers/macfarlane/media-releases/review-renewable-energy-target.

²³ In the case of the BAEconomics modelling, an economy-wide carbon price.

²⁴ Available at www.appea.com.au/wp-content/uploads/2013/06/APPEA-submission-on-RET-BAE-report.pdf.



- The fixed gigawatt hour target should be revised down to reflect the level that achieves the 20 per cent by 2020 commitment.
- The partial exemption certificates (PEC) provided to trade exposed industries, including LNG²⁵, to offset costs of the RET should be increased to 100 per cent.
- Amendments to the operation of the self-generation provisions contained in the current legislation are needed to remove some of the restrictions that the current eligibility provisions place on optimal project design, project viability and emissions outcomes.

PURCHASING EMISSIONS REDUCTIONS

Facilitating early participation in the Emissions Reduction Fund

As noted above, a variety of low cost, large scale abatement opportunities may come forward from the oil and gas industry, particularly if the ERF is designed with streamlined, efficient and effective administrative, reporting and compliance arrangements. The ERF will need to be designed to allow for the likelihood that differing types of emissions reduction opportunities could come forward at the same time, but may result in different payment mechanisms:

- Where a proponent has identified an emissions reduction opportunity (a 'project'), a successful bid into the ERF by this proponent would result in an 'Offtake Agreement'. This would be negotiated between the Regulator and the proponent for the future supply of emissions reductions and payments would be made as verified emissions reductions are realised. This could include a facility upgrade or an investment in a Carbon Farming Initiative (CFI) project. Individual 'Offtake Agreements'²⁶ will need to accommodate issues such as the life of agreement, the process for verification and so on (this is considered further below).
- Where a NGERs facility has managed to reduce emissions below the emissions threshold (as was considered further above) due to, for example, improved operational practices and wishes to bring forward under the ERF the already achieved emissions reduction – acceptance of this bid would result in payment for emissions already achieved.

Different projects may have different requirements and therefore differing arrangements may be negotiated with the Regulator, to mobilise the low cost large scale abatement sought under the ERF.

Operating an efficient auction process to secure lowest-cost emissions reductions

APPEA notes a number of auction model arrangements are possible and does not have a preferred option at this stage of the ERF's development.

²⁵ In the case of LNG, a PEC set at 60 per cent was included in Part 38 of the *Renewable Energy (Electricity) Amendment Regulation 2012 (No. 1)*, which amended the *Renewable Energy (Electricity) Regulations 2001* and was made on 22 February 2012. This means that the industry remains exposed to significant additional costs associated with the RET. This reduces Australia's international competitiveness for LNG production and does not reduce greenhouse gas emissions in Australia.

²⁶ Examples of agreements of this type exist (or have existed) through various programs. Recent examples include the Department of Industry's Solar Cities program (see ee.ret.gov.au/energy-efficiency/solar-cities/solar-cities-program-resources) or the Department of the Environment's National Carbon Offset Standard Carbon Neutral Program (see www.climatechange.gov.au/climate-change/carbon-neutral/carbon-neutral-program).



The ultimate auction model should be developed in consultation with stakeholders and be subject to rigorous testing (including a pilot) before the first ERF auction process is conducted.

It will also be important that any auction system developed be able to accommodate the diversity of bids that may come forward for funding under the ERF. Bids are likely to vary, potentially significantly, in terms of scale, timing, deliverability, technical and commercial complexity, degree of co-funding and a variety of other metrics.

The auction design must be able to accommodate these variations as well as providing a well understood methodology to allow differing bids to be prepared. This will be important to ensure the auctions appropriately identify (and subsequently fund) genuine low cost large scale abatement projects and below emissions threshold emissions reductions.

To assist price formation and market development, aggregated data on the volume and nature of emissions abatement and the price bid, along with the auction closing price should be made publicly available while protecting any commercial sensitive information, particularly relating to individual bids.

APPEA looks forward to further consultation on the specifics of auction design as the ERF is further developed.

Standard contracts will be used to guarantee payments for verified emissions reductions. These would have a maximum duration of five years and include options for addressing under-delivery of emissions reductions

As noted above, successful bids into the ERF (particularly through the specific 'projects' that may be bid into the ERF) could result in an 'Offtake Agreement' to be negotiated between the project proponent and the Regulator.

Such an 'Offtake Agreement' would include details on the monitoring, verification, compliance and payment arrangements.

Where possible, such arrangements should be built from existing (but simplified) infrastructure and could draw on existing and/or previous models of funding arrangements of this nature.

To recognise (and encourage) a large and diverse range of low cost large scale emissions reduction opportunities to be bid into the ERF, a number of standard 'Offtake Agreements' is likely to be required.

While a 'one size fits all' Agreement may aid in simplifying the operation of the ERF, such simplification is likely to come at the expense of significantly limiting the range of low cost large scale emissions reduction opportunities that may otherwise be able to bid into the Fund. APPEA recommends the Government design a flexible set of 'Offtake Agreement' arrangements to avoid this outcome.

The Green Paper proposes on page 31 that

Contracts would have a maximum duration of five years from their date of effect.

As APPEA has noted, a variety of low cost, large scale abatement opportunities may come forward from the oil and gas industry, particularly if the ERF design is designed with streamlined, efficient and effective administrative, reporting and compliance arrangements.



Specifying a contract period as short as five years would act as a significant barrier to entry for a range of more capital-intensive abatement opportunities, many of which may be large-scale and involve the reduction of significant amounts of greenhouse gas emissions. It is also inconsistent with the design principles set out on the Green Paper, particular the 'streamlined administration' principle. Limiting contract duration to five years will not make it easy for businesses to participate.

APPEA recommends the Fund does not feature a maximum contract duration. The duration of contracts should be a matter agreed between the Clean Energy Regulator and successful Fund participants.

APPEA agrees as the Green Paper states on page 32 that

Projects will be subject to a range of uncertainties that could affect the timing and amount of emissions reductions delivered. For example, projects could experience unexpected technical difficulties or be affected by natural events beyond the proponent's control.

We do not agree, however, that 'make good' provisions should be a feature of the ERF's design.

The Green Paper proposes on page 29 that only

... credible bids that meet prequalification requirements would be considered, to ensure the integrity of the auction ...

The upstream oil and gas industry has significant experience with prequalification arrangements for acreage release bidding programmes under the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* (OPGGS Act). The OPGGS Act requires that bidders for acreage under the acreage release programme be prequalified (based on, amongst other things, an assessment of their technical and financial capacity) as part of the bid assessment process. Such a prequalification process, based on the OPGGS Act, could be developed for the ERF.

An appropriately applied prequalification process would remove the need for 'make good' provisions. Having both a prequalification process and a 'make good' provision would inappropriately weight commercial risks towards ERF participants and is likely to add as a barrier to bidding into the Fund and therefore both lower participation in bidding rounds and inefficiently increase the clearing price required in an individual bidding round.

In drafting the pro-forma contracts for the delivery of abatement, the Government will need to carefully balance risk to be carried by both the bidder and the Government. For many potential participants, including a make good provision will be viewed as placing an inappropriate commercial risk on the bidder. The bidder is already assuming a significant level of risk in developing and bidding the opportunity into the ERF. If successful in receiving a contract the bidder will then be undertaking the opportunity in the knowledge if the opportunity does not deliver on time, for example because of a weather delay, they will not receive payment.

To impose an additional make good provision will simply add further commercial risk that may result in potential participants either electing not to bid or participants increasing their bid price to cover this additional risk. Neither outcome is consistent with the ERF delivering lowest cost abatement.

The prequalification process can screen out those projects that may not deliver on time as part of the tender. In the event abatement is not delivered as contracted, Government retains the option of taking the funds saved as a result of the non-delivery and either re-tendering these funds back



into the ERF, or using the funds to directly purchase Australian Carbon Credit Units (ACCUs) or credible international units on the secondary market.

This would ensure that, over time, emissions reduction targets were achieved and emissions abatement occurred at least cost for all participants, including successful bidders, and provide confidence that projected emissions reductions will be delivered.

CARBON FARMING INITIATIVE

Expanding the Carbon Farming Initiative

A cumbersome and time-consuming process underpins the development of CFI methodologies. This process, which has involved a number of APPEA member companies, will be too complex to support the diverse range of low cost large scale abatement projects that may be bid into the ERF. Indeed, use of the current CFI methodology approach would constitute a barrier to entry to the ERF for many potential participants, leading to a lower level of participation and a 'thinner' range of bids than would be the case if a simplified process was utilised.

APPEA recommends whichever methodologies are used to underpin the ERF, including any that are built from the existing CFI process, should involve streamlined, efficient and effective administrative, reporting and compliance arrangements.

In reporting a facility's emissions, firms should be able to use recognised credible offsets to reduce the level of emissions reported. This should include Australian offsets generated under the CFI including the use of ACCUs purchased on market. It will be important that the White Paper clarify the role ACCUs will play within the ERF framework, including whether CFI projects funded by the ERF will still receive ACCUs.

Existing greenhouse gas abatement investments that are or would be eligible to generate ACCUs under the existing CFI rules should continue to be eligible to generate ACCUs that can be sold under the ERF.

Where a facility operator uses offsets to reduce the emissions reported, it should be facility emissions that determine the emissions threshold. Offsets should not be considered when establishing a future emissions threshold for that facility.

ADMINISTRATION

APPEA supports the continuation of the Clean Energy Regulator and the assignment to it of key responsibilities for administration of the ERF in addition to its ongoing responsibilities around the administration of NGERs. APPEA recommends, as is usual practice, ongoing policy responsibility remain with the Minister and with the Department.

The Government should also establish and fund an ongoing Advisory Board to work with the Department and the Regulator on governance and administrative arrangements for the ERF. This can ensure the Regulator has access to an ongoing source of advice on ERF experiences and can ensure both the ERF and NGERs operate in an effective, effective and 'fit for purpose' manner. Such a Board would be in addition to the governance arrangements set out in Figure 6.1 on page 49 of the Green Paper.

As with the CFI, administrative streamlining will be required to NGERs facilitate the development of a diverse and 'deep' range of emissions reduction opportunities under the ERF.



APPEA supports the use of a simplified NGERs as the basis for reporting of emissions under the ERF, particularly for emissions thresholds and to underpin the ability for NGERs facilities to bid below emissions threshold reductions into the ERF. As part of this, APPEA recommended in its 4 November 2013 submission²⁷ to the Government on the carbon tax repeal Bills that, following the repeal, the NGER Act will still require a thorough review to ensure it is achieving its objectives in the most effective way. It should minimise reporting burden for those required to report under the Act.

The additional changes required to be made to the NGER Act post the passage of the repeal Bills include:

- Removing the need to report uncertainty (as currently required under section 19 of the NGER Act). While Australia may have an obligation under the United National Framework Convention on Climate Change to report uncertainty in Australia's national inventory, it is not clear how the uncertainty obligations applied to individual reporting entities add to the utility of this data.
- Greatly simplifying the reporting requirements for small energy uses (and users). There is a particular need to simplify (and clarify) energy-related reporting obligations. For example, in addition to the energy reporting requirements in the NGER Act, APPEA member companies still face reporting obligations under oil and gas licences and to the Australian Bureau of Statistics on a range of energy production and consumption-related data series.

The Government should commission from the Department of the Environment and the Clean Energy Regulator a separate review of the NGER Act and associated reporting obligations. This review should have as one of its core purposes a significant simplification of current reporting obligations, consistent with the Government's overall red tape and green tape reduction programme.

CONCLUSIONS/NEXT STEPS

Our abundant natural gas resources place Australia in an enviable position to maintain long-term, cleaner energy security domestically and internationally. Natural gas makes it possible for Australia to meet the world's growing energy needs over the coming decades while incorporating a strategy to curb emissions and address the risk of climate change.

APPEA will continue to participate in the further development of the ERF and looks forward to ongoing consultation with the Government and the Department as the ERF is further developed, ahead of the release of the ERF White Paper later in 2014.

In particular, APPEA recommends detailed consultation on the proposed legislative provisions to implement the ERF, the further development of the safeguard mechanism and the further development of facility methods. Detailed 'road testing' and 'stress testing' of the administrative provisions that will need to be developed to implement the ERF should be conducted.

²⁷ Available at www.environment.gov.au/carbon-tax-repeal/consultation.html.