



The Shell Companies in Australia

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8 April 2009

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

Dear Sir/Madam,

The Shell Companies in Australia:
Submission to the Senate Select Committee on Climate Policy

The Shell Companies in Australia ("Shell") appreciate the opportunity to make this submission to the Senate Select Committee on Climate Policy.

Shell recognises climate change as a critical global issue. Getting climate change policy and legislation right is critical to success in reducing Australian and global emissions.

Notwithstanding the current economic situation, Shell believes there is urgent need for national and international policy implementation to combat climate change. In our view, it is vital that all governments develop market-based policies and supporting legislation that recognise the need to address both the world's growing energy demand and climate change issues. It is important that industry is provided with regulatory certainty so that it can make the necessary adjustments required to help combat climate change whilst continuing to contribute to economic and employment growth.

Shell submitted an extensive commentary on the proposed Carbon Pollution Reduction Scheme Green Paper in September 2008. In that document Shell supported the introduction of an emissions trading scheme in Australia. A copy of this submission is attached.

Emissions Trading

Emissions trading is claimed to be overly complex. In fact, the structure is remarkably simple but like almost any policy instrument can be made more complex to meet a variety of special interests. No matter how policy proceeds, certain building blocks will be necessary ;

- Monitoring and verification of emissions.
- Government oversight to ensure compliance

- Installation level (i.e. the point of emissions) reporting. Proponents of a carbon tax often argue for a simple point of tax collection at the top of the value chain (e.g. at the coal mine or oil well or point of import). However, a crediting system would still have to be devised for downstream projects that eliminate emissions (e.g. a carbon capture and storage project). Crediting would then require installation level oversight, measurement and verification. In a coal-based economy such as Australia, this could be quite extensive.

Emissions trading is claimed by some to not work in practice. But experience shows that trading system will deliver what it is asked to do.

- The US sulphur trading system has delivered the necessary cuts in sulphur emissions.
- The first phase of the EU Emissions Trading System was over supplied with allowances as governments did not have robust data on which to base allocation. This ultimately led to a price of near zero for a 2007 vintage allowance. But there was no design error in the trading system itself, simply an oversupply of allowances and an inability to bank allowances forward, a temporary design feature driven by the Kyoto Protocol.

Shell stands behind emissions trading as the best policy approach to accelerate the deployment of available low carbon technologies so as to reduce greenhouse gas emissions.

Advantages of Emissions Trading Schemes

Emissions trading is already the policy instrument of choice in the EU, the US NE States and the US Acid Rain Programme. Shell sees the following advantages of such an approach :

- **It is designed to deliver an environmental outcome, in that the cap must be met.**

This is critical for the environment. While other policy instruments, for example a carbon tax, may deliver some level of fiscal certainty, they may not necessarily deliver any particular environmental outcome. Emissions could fall, but equally they may continue to rise, requiring policy makers to look for other measures necessary to deliver a given emissions reduction pathway.

- **It will deliver its environmental objective at lowest cost to the economy.**

By combining trading with a price for emitting CO₂, the approach seeks out the most attractive reduction projects within the market, delivering a lowest cost outcome. Emissions trading is applied to the problem of sulphur emissions from power stations in the United States. The overall cost of the meeting the environmental goal has been much lower than expected.

- **A national trading system can be linked with other such systems, delivering over time a global carbon market. Developing countries can be linked through project based crediting.**

The bigger and broader the market, the wider the range of projects, leading to a lower overall cost.

- **A trading system offers both compliance and policy flexibility that is important for business.**

Compliance flexibility is delivered through the ability to "make or buy", i.e. to implement a project and make reductions (including selling allowances), or to buy allowances from others in the market.

Policy flexibility comes through the mechanism for distribution of allowances. For example, in Phase III of the EU Emissions Trading System some allowances will be distributed for free to deal with competitiveness concerns. Despite this, the incentive to reduce emissions remains in that the allowances have the same value because the level of the cap is retained. Offering a rebate or similar solution to the same problem in a tax based system would undermine the environmental outcome.

- **A trading system adjusts automatically during economic downturns.**

Under a trading system demand for emission allowances will decline during a recession as industrial activity falls, putting downward pressure on allowance prices. Such fiscal easing using alternative instruments would require government to specifically intervene by temporarily adjusting the financial drivers.

Transitional assistance for Emissions Intensive Trade Exposed (EITE) sectors

In the absence of a global carbon market, designing policy and legislation to minimise carbon leakage whilst maintaining incentives to reduce domestic emissions is difficult and complex. The treatment of Energy Intensive Trade Exposed (EITE) industries in the transition period prior to the introduction of a global carbon market is critical. Inappropriate design could significantly harm Australian industry in its competitiveness and may result in the shifting of economic activity and the carbon emissions associated with this offshore. The challenge is to design policy that provides incentives to reduce emissions whilst minimising this risk.

Shell acknowledges the substantial improvements in the policy design in the exposure draft of the CPRS legislation compared with the Green Paper. This demonstrates the value of broad consultation on an issue as complex as this. A continued open and cooperative approach between all stakeholders can help to achieve the best possible environmental and economic outcomes.

Shell's operations in Australia are predominantly manufacturing, distributing and selling petroleum products for the Australian market, and production of LNG for export. The government has identified both refining and LNG production as being EITE industries. We are currently working with the Department of Climate Change to define the activities for each of these industries as a first step to determine the rate of assistance they will receive within the EITE assistance programme. It is likely LNG will qualify for EITE assistance at a rate of 60 per cent. As a minimum, Petroleum refining is likely to qualify for 60 per cent assistance, but may qualify for 90 per cent assistance. At the 60 per cent assistance level, Australian refineries and LNG facilities will be severely disadvantaged compared with large regional plants that have no ETS.

Shell acknowledges the substantial improvements in policy design of EITE treatment, from the Green Paper to the White Paper. Shell notes there is no single measure for determining EITE that can be applied equitably to all industries within the economy. As such Shell supports the provision of options described in the white paper, particularly the inclusion of the value added option.

The definition of value added in the CPRS White paper is in fact a proxy definition and excludes some standard costs (as per the ABS definition). The value added proxy is in fact a reduced reflection from the 'true' value added eligibility measure. This will subsequently effect the overall allocation of assistance.

Shell recommends that the ABS definition of valued added be utilised in the EITE assistance programme, for the methodology for establishing eligibility and allocation.

To maintain the competitiveness of the Australian refining industry it is critical that refining as an activity qualify for assistance at a rate of 90%. Assistance at a rate of 60% only is likely to have significant negative impacts on refining viability. Local production would be displaced by imported refined products, which would reduce economic activity and jobs in Australia while having no net impact on global emissions.

Supporting policies

Whilst there is no question that emissions trading will be an important part of the necessary policy approach to reduce emissions in Australia, on its own it is far from the comprehensive framework that is needed. Such a framework comes from a look at not just what is needed, but also a consideration of how it might be done.

The World Business Council for Sustainable Development publication *Pathways to 2050* (www.wbcsd.org/web/publications/pathways.pdf) showed that "mega-trend" scale changes will be required in four key sectors of the energy economy - power generation, industry & manufacturing, transport and buildings & commerce. Each of these sectors will need specific policy approaches to enable the necessary changes.

Technology will also be key to the changes required. Certain existing technologies must be rapidly deployed and a range of new technologies will need to be brought to market. A typical technology pathway model consists of three phases, Discover & Develop, Demonstrate and Deploy and each are needed to allow the technology to progress down the cost curve. Policy development often fails to consider the "demonstrate" phase, which sees the first commercial scale implementation of a particular technology and may require the construction of supporting infrastructure. Early infrastructure construction facilitates the shift to full deployment.

To fully enable the necessary changes to take place, policy must focus across all the sectors and along the full technology path. Whilst emissions trading is to be the principal deployment mechanism in Australia, its most powerful influence will be in the power generation and industry & manufacturing sectors. Complementary deployment mechanisms (discussed in our September submission) must still be implemented in the transport and buildings sectors. In addition, demonstration support for a variety of technologies will be needed in all sectors and a comprehensive research and development programme is required across the whole economy.

In the European Union, progress has been made in completing the framework. The recent passage through the EU Parliament of the Energy and Climate policy package included a significant support measure for the EU carbon capture and storage demonstration programme. At a CO₂ price of EUR 30, nearly EUR 10 billion will be available for commercial scale demonstration of this important technology.

Conclusion

As the legislation and required regulations are not complete, continued consultation is required to help achieve the most effective policy design, which in turn will help achieve the best possible environmental and economic outcomes. We, therefore, commend the government for proceeding with the CPRS, and recommend that Parliament reviews the legislation as appropriate and finds the political consensus required to pass the CPRS Bill into legislation.

Such an outcome will provide industry with the regulatory certainty to adapt to help combat climate change whilst continuing to contribute to economic and employment growth.

Should you wish to discuss anything further, please contact Tzila Katzel, Manager Greenhouse Gas on +61 (0) 3 8823 4201.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Russell R Caplan', written in a cursive style.

Russell R Caplan
Chairman



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10 September 2008

Green Paper Submissions
Department of Climate Change
GPO Box 854
CANBERRA ACT 2601

Dear Sir/Madam

The Shell Companies in Australia : Submission on the proposed Carbon Pollution Reduction Scheme

(submission emailed to : emissionstrading@climatechange.gov.au)

Shell Australia Limited, Shell Energy Holdings Australia Limited and their related bodies corporate in Australia ("Shell") appreciate the opportunity to make this submission to the Federal Government on the proposed Carbon Pollution Reduction Scheme ("CPRS").

Shell supports the introduction of an emissions trading scheme (ETS) in Australia and is engaging in constructive dialogue with the Government to facilitate the ETS implementation.

Shell considers it is vital that Governments in both the developed and developing world urgently develop policies and supporting legislation that recognise the need to meet growing energy demand and address climate change issues.

Shell considers the following to be fundamental for the effective and efficient management of emissions:

- action in all sectors is required to meet global emissions reduction objectives in a given timeframe at lowest cost;
- a central objective of climate change policy should be the efficient direction of capital within the market towards low and zero carbon emission investment;
- policy measures should be consistent across as broad a region as possible (e.g. between states, federally and eventually internationally);
- policy should be built on a sound, established and practical measurement and reporting basis; and
- any ETS policy should be built from a long-term (20+ years) environmental objective, with clear intermediate target points (i.e. each 5 or 10 years) to provide investment certainty and greater confidence in delivery of the aspired outcome.

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Further, Shell considers that well targeted complementary measures operating alongside the ETS are required to address market failures and drive structural changes more effectively than relying on an ETS alone. Effective complementary measures will help lower the costs involved with meeting the ETS emission trajectories, and create smoother transitions across abatement options.

In particular, Shell considers that the following measures are necessary to supplement the proposed CPRS:

- complementary measures in the transport sector, such as low carbon fuel standards (i.e. standards that aim to reduce carbon emissions on a "well-to-wheel" basis), vehicle efficiency targets and driver education programs;
- additional action in the commercial and domestic sectors, such as a series of enforceable energy standards for buildings and appliances, and incentives for retrofitting of existing infrastructure; and
- support for the discovery, development, demonstration and deployment of impending emission reduction technologies, such as Carbon-dioxide Capture and Storage (CCS).

Shell considers that the Government needs to consolidate and rationalise State and Federal legislation and schemes that conflict or overlap with the proposed national CPRS.

With respect to the Government's proposed CPRS outlined in the Green Paper, Shell has specific comments on the following areas:

- trade-exposed industries;
- carbon dioxide capture and storage; and
- transport fuels.

Our comments on these specific areas are attached in the accompanying document.

Should you wish to discuss any of the considerations and proposals raised in our submission, please contact our GHG Manager, Tzila Katzel, on +61 3 8823 4201 or +61 424 073 716.

Yours sincerely



Russell R Caplan
Chairman

Enc : Shell Companies in Australia : Response to the Federal Government's Green Paper on the Carbon Pollution Reduction Scheme

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**The Shell Companies in Australia:
Response to the Federal Government's Green
Paper on the Carbon Pollution Reduction
Scheme (CPRS)**

September 2008

SUBMISSION TO CARBON POLLUTION REDUCTION SCHEME - GREEN PAPER

Name of organisation:

Shell Australia Limited

Shell Energy Holdings Australia Limited

(Collectively referred to as "Shell" herein)

Name/s of author/s:

Russell Caplan, Chairman, The Shell Companies in Australia

Date:

10 September 2008

Confidentiality statement:

I do not want this submission to be treated as confidential and/or anonymous

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1 Executive Summary

Shell supports the introduction of an emissions trading scheme (ETS) in Australia and is engaging in constructive dialogue with the Government to help this happen.

There are three areas of the Green Paper on which Shell has specific comment:

- trade-exposed industries;
- carbon-dioxide capture and storage; and
- transport fuels.

1.1 Trade-exposed industries

Shell supports the Government's desire to assist industries that are emissions intensive and trade-exposed (EITE). However, Shell does not consider that the Government's proposed position is an efficient or effective way of providing assistance to EITE industries.

Shell recommends that the Government continues to pursue its sectoral analysis before finalising the design of the Carbon Pollution Reduction Scheme (CPRS) and that the Government does not use an emission per unit of revenue metric as proposed.

However, in light of the tight timeframes that the Government has set itself, Shell recognises that using the most economically efficient and effective methodology for allocating EITE assistance may not be possible. Therefore, Shell recommends that a "safety net" approach be adopted for the allocation of free permits to EITE industries, which would cap the cost of emission permits at a defined level of industry profit or value added.

1.2 Carbon-Dioxide Capture and Storage

Shell agrees with the Government that Carbon-Dioxide Capture and Storage (CCS) is a necessary technology to enable the world and Australia to meet their emission reduction aims. However, Shell does not consider that the market price of carbon will be sufficient to commercialise CCS in the timeframe that is required to reduce emission. Therefore, Shell recommends that the Government provides a greater level of funded support for CCS demonstration facilities in Australia.

1.3 Transport Fuels

Shell supports the Government's proposal that the Customs and Excise Duty point be used as the point of obligation for transport fuels. However, Shell does not consider that including transport fuels in an ETS, in isolation, will provide sufficient price incentives to reduce transport emissions, because of the low elasticity of demand. Shell considers that the Government needs to implement complementary transport emission reduction policies that help ensure that emissions from the transport sector reduce over time.

Shell is concerned about the Government's proposal to zero-rate all biofuels under the CPRS. Shell does not consider zero-rating all biofuels to be an effective way of reducing transport emissions.

2 Emission-Intensive Trade-Exposed industries

The Green Paper Summary states that, in the absence of a comprehensive global agreement on emissions reduction:

[Australian] trade-exposed industries may not be able to pass on the costs (of emissions imposed by the trading scheme) as they face prices set in international markets, and compete against firms that do not at this stage have comparable carbon constraints.

Further, the Green Paper states in the Summary that:

In the absence of assistance, if constraints on emissions are placed on activities in Australia but not elsewhere, there is a possibility that some emissions-intensive trade-exposed activities (EITE) may choose to leave Australia (or new investment could be discouraged). If these EITE industries choose to relocate elsewhere, with no consequent global reduction in emissions, it results in what is called 'carbon leakage'.

To ensure the effectiveness of the Carbon Pollution Reduction Scheme (CPRS), in the absence of a global climate change agreement, it is important that carbon leakage is minimised. An ineffective CPRS could result in Australian industries losing market share to international industries that do not face similar carbon costs, with negative consequences for Australia's economy.

Further, any reduction in Australian emissions will be nullified by an increase in emissions by the international industries that are displacing Australian production. An ineffective CPRS will mean that Australia exports its jobs and imports carbon emissions. Shell does not consider that this is the Government's intention.

Shell notes that the Summary of the Green Paper states:

The Government proposes to address [this problem] by providing a share of free permits to the most emissions-intensive trade-exposed activities.

and

The Government proposes to assist those firms that have a sufficiently material impact on their cost structures as a result of the scheme.

Shell supports the aims of maximising the economic efficiency of the CPRS and minimising the relocation of Australian industry where there is no consequent reduction in global emissions (carbon leakage).

Shell considers that targeted assistance to EITE industries by providing a proportion of free emission permits, would reduce the risk of inefficient carbon leakage and is an efficient way to minimise carbon leakage.

2.1 An economically efficient solution to address carbon leakage

Shell acknowledges that designing an ETS that minimises carbon leakage is difficult, but critical to achieving the most efficient outcome. The Green Paper advocates in section 9.1.3 that the CPRS design should support the:

"competitiveness of traded and non-traded industries, be economically efficient and be consistent with the environmental objectives of the scheme."

Shell considers that the extent of trade exposure and potential carbon leakage will vary widely between different Australian industries and activities, and these differences will depend on:

- how much energy is consumed by the different industries in their production process (energy intensity); and
- the extent to which increased costs can be recovered from the market (trade exposure).

In practice the degree of trade exposure faced by different industries will vary widely. Industries that are more trade-exposed will be subject to higher potential carbon leakage and therefore require a greater level of assistance. To achieve maximum efficiency, Shell considers that the allocation of free permits to the trade-exposed activities must take the degree of trade exposure into account.

The Green Paper examines a range of measures of trade exposure including:

- examining trade shares;
- estimating the price elasticities of individual products; and
- examining correlations between relevant global and domestic prices.

The preferred position identified in the Green Paper is not to attempt to distinguish between degrees of trade exposure, but to include all industries where no physical barrier to trade exists as "trade-exposed". The explanation for this decision in Section 9.3.3 is:

Estimating specific price elasticities and examining movements between the prices of domestic and comparable international goods would be an alternative way of assessing the relative capacities of industries to pass through cost increases. These are complex exercises subject to numerous assumptions. The Government does not believe that a robust methodology could be developed to conduct such an exercise in a fair and comparable way across a wide range of industries and activities.

On balance, the Government's assessment is that it is not possible to provide a practical, transparent and robust test of the relative capacities of different industries to pass through cost increases.

Shell considers that for an optimal solution, the primary criterion for assistance to trade-exposed industries should be whether they are actually trade-exposed. The mechanism for allocation of assistance should be based on an assessment of an industry's inability to pass costs into the market on the basis of its trade-exposure.

Shell acknowledges the difficulties associated with accurately quantifying the relative ability of individual industries to pass through cost increases, particularly in the timeframe proposed for implementation of the CPRS. However, Shell considers that there is merit in the Government continuing to pursue its sectoral analysis to assess trade exposure before it finalises the design of the CPRS.

Adopting a more comprehensive and robust definition of trade exposure would allow the Government to target industry assistance more efficiently, and lower the total cost of reducing carbon leakage. Implementation of rigorous trade exposure criteria would provide the most economically efficient use of consumers' and industries' money to fund emission reduction in the transition to a comprehensive global scheme.

Shell recommends that the Government continues to pursue its sectoral analysis to assess trade exposure properly, to allow efficient targeting of those industries that are trade-exposed before it finalises the design of the CPRS.

2.2 Emission per unit revenue is inefficient and inequitable

The Green Paper proposes that assistance be provided to EITE industries on the basis of a measure of emissions per unit of revenue. Shell considers that the proposed revenue measure fails to achieve the Government's stated objective as outlined in section 9.4.1 that:

"EITE industry assistance should be targeted to activities for which the carbon cost impost is most significant and material."

The proposed revenue measure takes no account of the capacity of an EITE industry to recover increased costs from the market or the materiality of the cost increases relative to the industry's profits or value add. Therefore, Shell considers that the proposed measurement of emission per unit of revenue as a basis for allocating assistance to trade-exposed industry is inefficient and inequitable. It is not an effective means of reducing risks associated with carbon leakage and is likely to lead to unintended consequences.

Using the proposed revenue metric will result in big losers and big winners. The big losers will be those industries that do not qualify for assistance but are heavily trade-exposed and would not recover costs in the market. The big winners will be those industries that do receive assistance and are not heavily trade-exposed, and could pass on the cost of the scheme to their customers.

Shell strongly recommends that the proposed emission per unit of revenue measure not be used by the Government to assess EITE assistance for carbon leakage.

2.3 Providing a "safety net" for existing trade-exposed industries

Shell proposes that a "safety net" approach be used for existing trade-exposed industry.

Under the "safety-net" proposal, the cost of permits would be capped at an agreed safety net threshold, set at a defined share of industry profit or value added. Permit costs above the safety net threshold would be offset by the allocation of free permits.

The "safety-net" approach would help minimise carbon leakage by targeting assistance to those industries that face the highest relative cost burden and are therefore more likely to be competitively disadvantaged by the introduction of an ETS. By setting the "safety net" at a modest level, the approach does not need to increase the amount of industry assistance; rather it is designed to allocate this assistance more efficiently and more equitably.

Allocation of these free permits should be defined at the commencement of the CPRS, based on estimates from a set of baseline years (e.g. average profit/value-add over the previous 5 years). Such a "safety net" would help minimise carbon leakage from firms already operating in Australia.

Shell recommends that assistance to EITE industries by provision of free permits not be artificially capped at 20 per cent of total permits. However, if the Government chooses to maintain this element of the scheme design, this could be accommodated within a "safety net" proposal by adjusting the "safety net" threshold.

Shell Australia's submission on the proposed Carbon Pollution Reduction Scheme

Shell suggests that a "safety net" approach be adopted for the allocation of free permits to EITE industries that would cap the cost of emission permits at a defined level of industry profit or value added.

2.4 Benchmarking for new trade-exposed activities

The potential for carbon leakage is greater for new activities where capital costs have not been sunk. Investment decisions by firms will be made on a range of criteria. Under the CPRS, the incentive to invest in Australia is reduced, as new investment in Australia incurs a carbon cost that is not borne in competing countries.

The shifting of new EITE activity offshore is an extreme form of carbon leakage. In theory, to avoid this problem, free emission permits should be provided to the extent that potential projects that would have proceeded are not discouraged from doing so because of the need to purchase permits. In practice this is very hard to quantify.

Shell considers that a potential way to deal with this issue would be to provide significant new EITE activities with an allocation of free permits within the cap, up to the level of emissions equivalent to the "world's best practice" emissions benchmark for the facility.

Under the proposal, firms would purchase emission permits for all emissions above this best practice benchmark. As the proposal is designed to reduce the risk of large-scale carbon leakage, the assistance would only apply to significant new activities that pass a materiality threshold based on the level of emissions.

Benchmarking would help minimise the risk of carbon leakage from new facilities locating offshore and provide the incentives required for new facilities to adopt best practice technology to reduce emissions.

Whilst benchmarking can be a complex exercise, it is relatively simple to create best practice energy efficiency benchmarks, such as emissions produced per unit of production. Shell is confident that both Liquefied Natural Gas (LNG) facilities and petroleum refineries could be suitably measured under this approach, along with other facilities such as aluminium smelters.

Shell suggests that assistance for significant new EITE investments be in the form of free permits equivalent to the "world's best practice" emissions benchmark for the facility.

2.5 Refineries are trade-exposed

Australian petroleum fuels are priced on an import-parity (Singapore price plus freight) basis. Imports by major oil companies, independent distributor-marketers and independently operated terminals provide the price-setting mechanism for refined products. Therefore, Australia's refineries are "price-takers" in the Australasian market with no capacity to recover carbon costs.

Australia's refineries are already under significant competitive pressure from refineries in Asia.¹ Further cost pressures arise from the obligation to produce Australian specification clean fuels. There is very limited capacity to pass on any increased domestic refinery costs to Australian consumers, as the competitive context in which Australian refiners operate is the Asian market. Because of the competitive context, there is very limited, if

¹ For example, Reliance's Jamnagar refinery in India will start production this year from an expansion that is almost equivalent in size to all of Australia's refining capacity combined. It will have much greater crude choice flexibility and hence lower input costs.

any, capacity for Australian refineries to pass on the costs of carbon resultant from the CPRS.

Under the emission per unit of revenue metric proposed by the Government, refineries do not meet the proposed threshold for assistance and therefore will not qualify for any free permit allocations. Consequentially, the costs of permit acquittal for refineries (with no assistance as a trade-exposed industry) are likely to consume a large portion of the total profit or result in loss making from this activity. This poses a real and significant threat to the viability of the Australian refining sector.

Shell strongly considers that retaining Australian refining capacity is important for security and diversity of transport fuels supply in Australia. Australian refineries provide thousands of jobs directly and indirectly, as refineries have very high multiplier effect, and provide significant tax revenue for the economy. In addition, domestic refining increases the capacity of Government to define petroleum fuels standards that best fit the environmental needs of Australian cities.

Shell considers that the refining industry is trade-exposed and under significant threat from international competitors that do not have stringent environmental protection laws or an ETS.

Shell strongly recommends that the Government considers the viability of the domestic refining industry under the proposed CPRS and allocates permits to refineries accordingly.

2.6 LNG projects and trade exposure

The world will continue to depend to a great extent on fossil fuels in the coming 50 years. Natural gas has the lowest carbon emissions of all fossil fuels. The Australian LNG industry has significant potential for growth over the next two decades, taking advantage of the strong demand for gas in Asia Pacific markets.

The development of LNG projects in Australia provides large economic benefits and tax revenues. These projects can also make a very large contribution to reducing global CO₂-e emissions by displacing higher emission fossil fuels, such as coal, in the countries to which Australia exports.

As Australian LNG is a "price taker" in world markets, there is no capacity to recover higher carbon costs from the market until the majority of Australia's international trading partners and competitors implement a scheme that puts a similar price on carbon emissions.

Shell considers that any additional cost imposed on a project in Australia, but not elsewhere, will reduce the attractiveness of LNG investment in Australia.

Under the proposed CPRS, Australian LNG projects are not eligible for EITE assistance. This will place potential new Australian LNG projects at a competitive disadvantage to competing projects in other countries, increasing the risk that investment in new Australian LNG projects will be deferred or abandoned as a consequence of the CPRS. Such an outcome would have negative consequences for the Australian economy and for the global environment.

Shell recommends that the Government considers the significant contribution that new and existing LNG projects make to the Australian economy, and allocates permits to new and existing LNG projects accordingly.

3 Carbon-dioxide Capture and Storage (CCS)

3.1 More Government support is required

The Green Paper Summary states that:

CCS will necessarily be a critical part of any global solution" [to address climate change].

and in section 2.4.6 that:

carbon that is transferred to CCS facilities would be netted out of the originating entity's gross emissions.

Shell agrees with the Government that CCS is a necessary technology to enable the world and Australia to meet their emission reduction aims.

Shell considers that CCS technology is one of the few technologies that are entirely driven by climate change policy. It is, however, becoming increasingly clear that deployment of CCS technology will not happen without policy intervention. Shell considers that a carbon price alone will not provide sufficient incentive for the commercialisation of CCS in the timeframe required. Therefore, Shell strongly recommends that Government provides sufficient additional financial support for the rapid development of CCS technology.

Given that CCS is an emerging technology, there are several important phases to its commercialisation. Shell considers that CCS technology has been discovered and developed, but assistance is necessary for the demonstration phase of CCS. Internationally, there is large-scale example of end-to-end CCS in conjunction with clean coal technology.

The "demonstration" phase for CCS needs financial support as the technology is still in the upper part of the carbon abatement cost curve. The incentive provided by a carbon market alone, will not typically be sufficient to enable demonstration facilities to be built (i.e. the first few installations of the technology) as the infrastructure costs are significant. Once the required CCS infrastructure is set up, the costs involved in CCS decreases due to economies of scale. Consequentially, Shell considers that direct additional Government assistance is required for CCS technology to be demonstrated.

Once the technology has been demonstrated and begins to enter the deployment phase, Shell considers the financial incentive from the carbon market is likely to be sufficient to ensure further facilities are developed.

Shell strongly recommends that the Government provides a greater level of funded support for CCS demonstration facilities in Australia.

3.2 Mechanisms to support CCS

Shell recognises the National Clean Coal initiative as an important support mechanism for CCS, but does not consider the funding to be sufficient to ensure that CCS (for clean coal projects) is commercialised in Australia.

Shell proposes that Australia contributes to launching 20 CCS demonstration projects by 2010, called for jointly by the International Energy Agency and the G8. Shell considers that the principle of funding CCS project commercialisation is that of providing for the

public good (just as the Government provides roads, schools, hospitals, and other infrastructure).

Mechanisms for subsidies that the Government should consider include:

- direct payments (partnership between Government and the private sector);
- hypothecation of funds from allowance auctioning; and
- differentiated allowance allocation that favours early CCS demonstration projects.

Subsidies should be employed until learning-by-doing incentivises cost reduction, making CCS competitive within the ETS.

3.3 Recognition of CCS in the trading scheme

Shell supports the Green Paper proposal that “Carbon that is transferred to CCS facilities would be netted out of the originating entity’s gross emissions” (pg 108), based on the accounting methodologies and requirements of the 2006 IPCC GHG Inventory Guidelines and the general advice on site selection in the IPCC Special Report on CCS.

Further to what is covered in the Green Paper, Shell strongly supports the inclusion of CCS in the Clean Development Mechanism (CDM) of the Kyoto Protocol, supported by appropriate and robust verification processes, as the main means of making CCS commercially feasible in countries where emissions will rise most rapidly in the near future.

Certified Emission Reduction (CERs) units generated under the CDM from CCS projects internationally should be given preferential treatment within the Australian trading scheme, such that no limits to the use of CCS-generated CERs apply. Shell considers that any arguments for limits (based on the desire to spur domestic action) are outweighed by the benefits of early CCS projects being delivered in developing countries.

Working with IPCC and the European Commission, Shell has acquired considerable expertise on matters related to CCS policy and technology. Shell looks forward to engaging and working with the Australian Government on further details regarding CCS technology, the inclusion of CCS in the CPRS, and in the CDM.

4 Transport fuels

Shell is one of the main suppliers of transport fuels in the Australian market, providing more than 9 billion litres of fuels to Australian motorists and businesses each year.

4.1 A systematic policy approach is needed

The Green Paper states in section 2.4 that the preferred position on coverage is to include transport fuels in the trading scheme.

Shell does not consider the inclusion of transport fuels in an ETS, in isolation, to be an efficient or effective way to reduce transport emission. Inclusion of transport fuels as the only signal to promote behaviour change in the transport sector is likely to result in minimal abatement in the short to medium term, because of the relatively low elasticity of demand.

Long term, inclusion of transport fuels in the CPRS may lead to additional changes being imposed on the sector in a rapid and inefficient manner, due to the lack of early abatement achieved in the transport sector. Therefore, Shell supports the implementation of a small number of mechanisms across the transport sector, designed to promote a smoother transition for the transport sector to a lower emissions outcome. These include, but are not limited to, complementary policies on vehicle efficiency standards.

Shell recommends that the Government implements complementary transport emission reduction policies:

- **vehicle efficiency standards;**
- **incentives for low carbon fuels such as advanced/next generation biofuels; and**
- **measures to influence driver behaviour and mobility choices, including increased investment in public transport.**

Shell recognises that the Government has proposed to include transport fuels in the trading scheme, and assuming this position does not change, Shell looks forward to engaging with the government to ensure that the details of inclusion of transport fuels are implemented in the most efficient and effective manner, with least administrative cost burdens.

4.2 Using the Customs and Excise Duty as the point of obligation

In section 2.10, the Government proposes that the:

...obligations for emissions from fuel combustion would be applied at all fuel excise and customs duty remission points for all liquid fuels currently subject to Fuel Excise and Excise-equivalent Customs duty, with thresholds to exclude smaller customs duty remitters to be determined.

Shell agrees that having the point of obligation with individual motorists is not realistic until such time as appropriate Information Technology systems exist. Therefore, Shell agrees that the optimal point of obligation for transport fuels is at the Customs and Excise Duty point. However, Shell is concerned that the Green Paper proposes to exclude smaller customs duty remitters. Shell considers that providing exemptions to exclude small customs duty remitters will not result in equitable treatment of providers in the liquid fuels market.

Shell strongly recommends that no exemptions for small customs duty remitters be allowed unless they are exempt from being subject to fuel excise and excise-equivalent customs duty.

4.3 The "opt-in" provisions need some restrictions

The Government is proposing that an "opt-in" provision for large fuel users be explored after 12 months of the scheme operating. This would allow large fuel users to decide whether they manage their own emissions and compliance or not (pages 100 and 118).

Shell considers that any "opt-in" provision must incorporate strict restrictions on the notice period before opting in, to ensure that companies are not choosing to "opt-in" on an opportunistic, short-term assessment of risk and reward. The notice restriction is required to ensure that fuel suppliers can change their emission requirements for compliance depending on whether a large user customer is "opted-in" or not.

Shell recommends that suitable restrictions on the notice periods are required for large users to opt-in to self-acquittal under the scheme.

4.4 Zero-rating all biofuels is too simplistic

The Green Paper states in section 2.17 that all biofuels are zero-rated for emissions and would be exempt from the CPRS emissions obligation.

Shell considers that zero-rating all biofuels is too simplistic to realistically address the biofuels sector, as the production emission intensity and sustainability of different biofuel feedstock varies greatly.

Shell is concerned that by zero-rating all biofuels, an inequitable situation will be created if some biofuel feedstock is domestically produced and some is imported. Imported biofuels will not have growing, harvesting, production or transport costs of carbon included in the price of the feedstock/product until biofuel exporting nations implement similar GHG lifecycle or Well to Wheels (WtW) performance assessments and policies.

The application of zero-rating of all biofuels will create an incentive for biofuels with poor WtW GHG performance to be used within Australia. By adopting a WtW GHG performance assessment and standards for biofuels to be used in the road transport sector, along with social/environmental sustainability standards, the Government can ensure that there is a level playing field within the biofuels sector in Australia. Further, this approach is aligned with approaches being adopted in other jurisdictions, notably Europe and North America, and most importantly that the use of biofuels plays an effective role in contributing to sustainable mobility in Australia.

Shell recommends that the appropriate Government agency undertake a WtW GHG performance assessment of various biofuel feedstock/production methods and provide an emissions rating for each feedstock/production method. Shell considers this is a more appropriate method for assessing the emission profile of biofuels. The methodology needs to apply both to imported and indigenous biofuels supplies for blending into gasoline and diesel.

Shell recommends that all biofuels sold in the transport sector be subject to Well to Wheel GHG performance assessment in order to determine the degree to which the biofuel is subject to emissions obligations.

Shell recommends that the Government should ensure that safeguards are adopted to ensure the social/environmental sustainability of biofuels use in the transport sector in Australia.

4.5 Liquefied Petroleum Gas (LPG) used for transport purposes

The Government proposes in section 2.12 that LPG be included in the CPRS and that the point of obligation is applied to producers, marketers, distributors, and importers of LPG.

Shell considers that the point of obligation for automotive LPG should be applied to the marketer of automotive LPG. Any obligation points further upstream make it much more difficult to identify whether LPG is being used in the transport sector, in stationary energy applications, or in industrial processes. Being able to identify the use of the LPG is important in determining emissions obligations under the CPRS.

Shell does not consider a "cent-for-cent" offset for LPG to be important as there are already considerable environmental benefits that are recognised and incentivised by the Government.

Shell recommends that the point of obligation for LPG be applied to the marketer of automotive LPG.