

BHP Billiton

Submission on Abatement Incentives Prior to Commencement
of the Australian Emissions Trading Scheme



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KEY POINTS OF THE SUBMISSION

1. The mechanics of early action credit and no disadvantage arrangements need to be considered against the backdrop of other emissions trading system design elements. These could be substantially impacted by the decision to ratify the Kyoto Protocol. More time should be allocated for consultation on settling the broad strategy before attempting to settle the detail.
2. Compensation arrangements for adversely affected assets represent an acceptable approach, focusing on assets in existence at 3 June 2007. However, the definition of 'assets' for compensation purposes must be broad enough to cover the full range of activities and commitments whose economics will now be degraded by the clear prospect of a national carbon price. Similarly ratification of the Protocol might have implications for target time periods. There needs to be careful consultation about the interaction between domestic and international schemes, targets over the medium and longer terms and their implications for the scale and nature of compensatory allocations of permits.
3. No disadvantage arrangements should clearly extend to abatement activities undertaken prior to 3 June 2007. Prior government commitments have been made on this issue, and there is considerable scope for emission reduction efforts to count against the interest of those who have moved early to reduce their emissions profile, relative to those taking action after 3 June 2007. BHP Billiton has several early action projects whose economics are likely to be undermined by currently proposed arrangements. Arrangements under the scheme can be no less comprehensive or generous than those under the Protocol that we have now ratified. For early action projects covered by State schemes there should be an opportunity to opt out of the State scheme and into the national scheme for the period 3 June 2007 until the national scheme commences.
4. Fair and practical approaches to early abatement and abatement crediting arrangements need to be developed, noting the small window of opportunity for crediting arrangements to be implemented.

BHP Billiton is pleased to provide input to the Federal government's emission trading design process. Developing an appropriate and effective response to the threat posed by climate change is an important policy task, and an area in which harnessing the support and capabilities of the private sector is vital. BHP Billiton continues to invest significantly in reducing the environmental footprint of its operations, and strives to achieve high levels of environmental performance consistent with growth and income objectives. We are a global company with a strong Australian asset base. It is in our interests and those of the wider Australian community to ensure that the policies developed to address climate change do not place an undue burden on our competitiveness, and are designed to ensure the strength and resilience of the Australian economy into the future.

Emissions trading offers the potential for integrating greenhouse gas abatement incentives into business planning, production and investment. BHP Billiton considers this to be a sensible course, but notes the need for development and implementation of such a system to be in tune with the adjustment capacity of key areas of the economy, and build on past and current abatement efforts. If industry is to acknowledge and work constructively on the challenging task ahead, it is incumbent on government to acknowledge action to date and build a solid base for future effort. Consideration of early abatement incentives is an important initial step in this process.

In developing its submission BHP Billiton has drawn on what it considers to be key design criteria for an early action system. We recommend them to policy makers in their further thinking on early action and emissions trading design. These are:

- simplicity;
- incentives for ongoing abatement effort; and
- recognition of past action.

These elements are likely to be important to the efficiency of the scheme, and also fundamental to its acceptance by industry — particularly those who have responded to past government commitments in good faith and undertaken significant beyond-business-as-usual investment to reduce emissions.

Eligible early action will generate recognition in the form of emission permits. The scale of these permit allocations will need to be considered alongside allocations to alleviate disproportionate burden, allocations to ameliorate carbon price impacts for trade exposed emission intensive industries and allocations to auction markets in the light of Australia's obligations under the Kyoto Protocol to deliver on Australia's 108 per cent emissions target for the 2008-12 period.

A credit for early action mechanism may also offer an attractive means of facilitating permit trading activity prior to the commencement of a mandatory system and offer benefits in terms of capacity building, price revelation and development of forward markets.

These are important issues. Yet they have not been raised in the discussion paper circulated, nor does the proposed timeline for consultation on early abatement incentives allow for them to be considered in the depth they deserve. For this reason, we have sought to address issues raised in the discussion paper at a high level, and suggest that early action incentive mechanisms may need to be revisited when other elements of the proposed trading system become clearer.

We consider that firm decisions on early action incentives and their potential contribution to broader economic and greenhouse objectives should not be made precipitously — particularly if these risk closing off an important mechanism for driving additional abatement in the near term and building the business constituency around emissions trading. These can be important factors in encouraging business to seek out and embrace greenhouse opportunities in the future.

A further issue relates to the scope of the 'no disadvantage' commitment presented in the discussion paper. We note Prime Minister Howard's announcement of 3 June 2007 that '... firms which undertake additional abatement between now and the start of emissions trading will not be disadvantaged'.¹ This is communicated within the discussion paper as precluding recognition and application of 'no disadvantage' for abatement undertaken prior to that date. This is a major departure from past commitments.

A 'no disadvantage' commitment was announced previously by the Industry Minister, Senator Minchin in 2000 in response to industry concerns about uncertainty associated with emissions trading and the risk that abatement action might count against the interests of industry participating in a trading system.

At that time Senator Minchin announced the Federal government's commitment to

'... avoid greenhouse gas abatement policies and measures that discriminate against new entrants to Australian industry or disadvantage 'early movers' in Australian industry who have previously implemented greenhouse gas abatement measures'.

Senator Nick Minchin, Minister for Industry, Science and Resources, Media Release entitled "Minchin releases details of greenhouse commitments to Australian industry", 6 September, 2000)

The practical implications of this commitment were subsequently explored by 5 working groups comprising government officials and industry participants. A jointly authored report on these deliberations was provided to government in March 2002. That extensive analysis concluded that the 'no disadvantage' commitment should be applied to abatement action undertaken from 1990, and possibly earlier if data quality issues could be satisfactorily addressed.

BHP Billiton notes the significant abatement effort that has been undertaken since that time — some of which has occurred as part of normal business, and some which is clearly beyond a business-as-usual scenario. Significant concerns over sovereign risk are triggered by the apparent intention of policymakers to walk away from the 'no disadvantage' commitment provided in 2000.

¹ Prime Minister John Howard address to the Liberal Party Federal Council, Westin Hotel, Sydney 3 June 2007, p.2

Early abatement action can clearly work to the disadvantage of industry under currently proposed arrangements:

1. early abatement of a similar type or quality to that proposed for crediting under consultation paper would be ineligible – even during the period 3 June 2007 to the commencement of the scheme – simply because the projects had commenced prior to that date, and under the assurances provided by government;
2. the economics of existing abatement projects could be severely undermined under proposed settings – particularly where those schemes generate credits under State schemes and where the value of those credits has been, or is likely to be, sharply diminished as a result of the introduction of national emissions trading; in these circumstances there should be an opportunity to opt out of the State scheme and into the national scheme during the period 3 June until commencement of the national scheme. This will require consultation with state governments and relief from/transfer of obligations under existing state agreements;
3. permit allocation on the basis of ‘disproportionate loss’ could be greater for those who have been slow to embrace greenhouse objectives and therefore have relatively high emission and or energy use profiles (placing early actors at a competitive disadvantage); and
4. eligibility for treatment as a trade exposed emissions intensive industry (TEEI) operator might be threatened by early efforts to reduce emissions output and exposure – particularly if these arrangements are based on eligibility or rate thresholds (with the potential for significantly increased operating costs for those businesses under a trading system).

These risks need to be explicitly considered and dealt with in the policy development process. They involve some complex issues and need to be addressed in a pragmatic and responsible manner, with reference to the objectives outlined above. Government decisions on early action and trading system design should not undermine the economics of past greenhouse investment, or harm the credit earning and permit allocation potential of operations that reduced their emissions profile prior to 3 June 2007, relative to those that cut emissions after that date.

Comments on issues raised in the discussion paper follow.

1. Ensuring allocation rules maintain abatement incentives

DATA SOURCES

It is proposed that the emissions trading scheme regulator use verified emissions data from the first mandatory reporting period under the National Greenhouse and Energy Reporting System as an input into permit allocations.

It is proposed that the regulator supplement this with verified abatement data from the previous year and draw on other relevant sources of data where this would assist in ensuring firms receive an appropriate allocation of permits.

Firms are encouraged to report abatement through the National Greenhouse and Energy Reporting System along with other corporate emissions and energy data, and to keep high quality records of abatement activity in the mean time.

Stakeholder advice is sought on relevant sources of data outside of NGERs that could be used for this purpose (eg, information from environmental approval processes or greenhouse or energy use programmes such as Energy Efficiency Opportunities).

Source: PMC Discussion Paper, p. 6.

BHP Billiton recognises that the NGERs framework and its associated data collection activities lays the foundation for the emissions trading monitoring and reporting system. However, there is a clear need to minimise (and recognise) the cost burden imposed by these activities.

Other sources of robust data should also be utilised. This should include data from the Greenhouse Challenge and Challenge Plus programs, where this information is of reasonable quality. This is an especially important source of information for data relating to activity prior to 3 June 2007, and government should leave the option open for companies to provide additional information as necessary to ensure that prior abatement action taken by them does not count against their economic interests in the permit allocation and crediting rules being developed under the national emissions trading system.

DEFINING ASSETS THAT ARE ELIGIBLE FOR COMPENSATION

Stakeholder feedback is being sought in relation to the definition of an asset “in existence” at the cut-off date. Feedback is sought in relation to the guidance afforded by the use of the National Electricity Market (NEM) definition and criteria for the electricity generation sector, and any necessary amendments to the criteria that may be necessary to give a similar outcome for other industries.

Source: PMC Discussion Paper, p. 7

BHP Billiton recognises the need for business decision making to reflect the prospect of future carbon constraints and their economic implications. The 3 June 2007 date of announcement of Government’s intention to implement a national emissions trading system is a reasonable point at which to draw a line beyond which Government expects industry to factor carbon costs into planning and investment. Commitments and investments entered into prior to that date whose economics will be adversely affected by adoption of carbon constraints should be eligible for compensation. Those commitments and investments need to be broadly defined — they include production sites already in existence, those being planned and developed (and which have involved significant expenditure and received appropriate board approvals) and agreements and contracts which extend beyond 3 June 2007.

BHP Billiton has a range of projects, facilities and contracts that will be impacted by a future carbon price. The economics of BHP Billiton’s coal mining operations are a high profile example of an asset whose value would be significantly affected by exposure to a carbon price in the domestic market — not only because of potential production cost impacts and emission liabilities, but also due to impacts on demand for their output. Such exposures and their potential impacts on competitiveness and asset value must be factored into system design and permit allocation decisions.

Pre-existing long term arrangements must also be recognised. BHP Billiton hosts a range of greenhouse gas abatement projects whose returns stand to be reduced by the proposed system because of its impact on pre-existing greenhouse programs — such as the NSW Greenhouse Gas Abatement Scheme (GGAS) and the Greenhouse Gas Abatement Program (GGAP).

EXHIBIT 1: APPIN-TOWER COAL MINE METHANE POWER GENERATION PROJECT

Illawarra Coal (a BHP Billiton subsidiary), working in conjunction with Energy Developments Limited (EDL) and Lend Lease Infrastructure, developed the Appin Tower Power Project in 1995. Appin Tower is a 94 MW electrical power generating facility with 54 gas engines located at Appin Colliery and 40 engines at Tower Mine.

The Power Project uses coal bed methane (CBM) from the Appin, Tower and West Cliff mines as the main source of fuel. In terms of technical and operational performance, the Appin Tower Power Project is exceeding all design targets for generation capacity, generator availability and engine efficiencies. Through a combination of equipment redesign and management practices, the plant operator, EDL, has improved the thermal efficiencies of the engines from 30% to 35% and the net power output of the individual engines from a nominated design base of 926 kW to 1030 kW.

Through combustion of methane that would otherwise have been drained from the mine sites and dissipated into the atmosphere the Appin Tower Power Project is contributing a direct GHG emissions reduction of

approximately 2.8 million tonnes (Mt) of CO₂ equivalent annually, plus an additional 0.6 Mt of indirect reduction through the displacement of coal-fired electricity. This makes Appin Tower one of the most significant GHG emissions reduction projects in Australia.

The electricity generated at the 94 MW plant is supplied to the local distributor, Integral Energy, and is estimated to be sufficient to power up to 60,000 homes. The facility is a registered abatement project, and generates NSW Greenhouse Abatement Certificates (NGACs), under the Greenhouse Gas Abatement Scheme. The revenue from these NGAC's is reflected in the Power Purchase Agreement between Illawarra Coal and Integral Energy, and has been essential to the ongoing viability of the project. The immediate prospect of a national emissions trading system has already impacted the value of NGACs.

WestVAMP, a new type of power plant, applies proprietary technology to use the extremely dilute methane in the ventilation air from West Cliff mine to generate electricity. It uses up to 20 per cent of the mine ventilation air to achieve a further reduction in greenhouse gas emissions for BHP Billiton Illawarra Coal of 250,000 tonnes of carbon dioxide equivalent every year. Like Appin, the West Vamp project is eligible for NSW Greenhouse Abatement Certificates and it would face significant economic penalties if these credits were not recognized in the national trading scheme.

After the commencement of the national trading scheme, BHP Billiton may gain a benefit to the extent that it might otherwise have faced a price for fugitive emissions from these mines, but up until that period, this project should be eligible for early credit recognition under the Commonwealth scheme, should BHP Billiton chose to transfer the asset to the Commonwealth scheme.

It is crucial that the proposed definition from the NEM (Appendix A of the Discussion paper) covers the full spectrum of industries and project development activities. In particular, BHP Billiton suggests broadening the NEM asset definition to include (additions are shown in red below).

- *The project proponent has acquired, or has commenced legal proceeding to acquire land for the construction of the project and/or the necessary right, licence or permit to exploit any key resource to be developed by the project.*
- *Firm contracts (subject only to conditions precedent which are conventional for the relevant industry) for the supply and/or construction of and/or entitlement to the project's major facilities, plant or equipment and other major inputs as applicable, have been executed and any condition precedent relating to a commitment by the project proponent to the project proceeding has been satisfied.*

[Note: As reflected in the text above, BHP Billiton suggests deleting from this element of the definition the list of example items of major plant and equipment given they would need to be numerous now that the definition is to apply also to industries outside the electricity generation sector. BHP Billiton also suggests deleting the wording "including provision for cancellation payments" in relation to the contracts, as this is too prescriptive and may not reflect the industry norm.]

- *The project proponent has obtained all required major planning, construction, development or production approvals and licences, as applicable, including completed and approved environmental impact statements (these include planning and environmental approvals from duly authorised planning bodies at both State and Federal Government levels.*
- *Financing arrangements for the proposal, if required, including debt plans, have been finalised and contracts executed*
- *Construction, excavation, installation or drilling with respect to a central element of the project has either commenced or a firm date has been set for it to commence.*

We note the critical importance of these definitional issues, and the need to consult extensively in order to refine them for legislative purposes. This process of refinement and improvement should be allocated as much time as possible, and certainly extend up to the time of drafting the relevant legislation.

2. Positive incentives to undertake additional abatement

ADDITIONALITY TESTS FOR CREDITS

It is proposed that credits only be provided for activities that represent abatement that has actually occurred, is additional, permanent, measurable, and verifiable.

Source: PMC Discussion Paper, p. 9

BHP Billiton notes the requirement to provide measurable and verifiable evidence of 'additionality'. However, in developing and applying these arrangements it is important to ensure that the cost burden on business is low, and that the 'no disadvantage' principle is applied to pre-June 2007 projects, which would otherwise be eligible to earn early action credits.

ELIGIBLE ACTIVITIES

It is proposed that there be no restriction on the types of activities that can earn credits prior to 2011 for use in the emissions trading scheme, provided they represent abatement that is additional, has actually occurred, and is permanent, measurable, and verifiable.

It is proposed that early action credits be generated from eligible projects for abatement after 3 June 2007 until the commencement of the scheme due in 2011.

Similarly, it is proposed that offset credits for use in the emissions trading scheme can be generated from eligible projects for abatement after 3 June 2007.

To be eligible, it is proposed that projects would need to be established after 3 June 2007.

Abatement projects could only be approved following final decisions as to eligibility of activities for offsets or early action credits for use in a future emissions trading scheme.

Source: PMC Discussion Paper, p. 10

As highlighted above the proposal to only recognise abatement from projects established after 3 June 2007 for crediting purposes, contradicts earlier undertakings of 'no disadvantage' to the extent that a project implemented prior to 3 June 2007 would be ineligible for early action credits, while the same project undertaken after 3 June 2007 would be eligible. In principal, the quality and beyond-business-as-usual abatement contribution of the project should be the criteria up on which credits are awarded — not an arbitrary start up date. The adverse potential impact of this approach on BHP Billiton projects has already been highlighted above in the context of our Appin/Tower and West Vamp abatement projects.

Ratification also raises the question of which domestic actions and offsets should be eligible for early credits and from when. It seems implausible that a "Kyoto forest" planted after 1990, but before 3 June 2007 should be eligible under the Protocol but not for an early action offset credit. Similar comments could be made in relation to international offset credits that would be eligible under the Protocol, but not necessarily be eligible under the scheme as proposed. As a matter of consistency early action and offsets carried out under State schemes and recorded with the Commonwealth and commenced before 3 June 2007 but otherwise meeting the criteria should similarly be eligible, at least in relation to emission reductions between 3 June 2007 and the commencement of the scheme.

USE OF GREENHOUSE FRIENDLY PROGRAM

It is proposed that the Australian Government's Greenhouse Friendly programme provide the initial administrative mechanism for approving offsets and early action credits in the emissions trading system.

It is proposed that the existing Greenhouse Friendly protocol for new forest offsets be used to assess eligibility following any government decision, but be reviewed in 2008.

Source: PMC Discussion Paper, p. 11

BHP Billiton highlights the need for a low cost and streamlined approval process for early action abatement crediting. A bureaucratic and overly engineered system will diminish early action incentives. The prospect of earning credits here and now adds to the abatement impetus provided by an unspecified carbon price to be introduced in 3 or 4 years time. The Greenhouse Friendly Program is a pre-existing abatement crediting program, but it has a very limited track record in approving offsets in a timely and efficient manner.

DEVELOPMENT OF CREDITING PROTOCOLS

It is proposed that streamlined protocols be developed for eligible early action and offset projects. Stakeholder feedback is sought on priority project activities for protocol development.

Source: PMC Discussion Paper, pp. 12

BHP Billiton supports the development of streamlined eligibility protocols as a way of minimising the regulatory burden on firms. Given the short lead times between now and 2010-11, it is critical that protocols that can be applied with reasonable levels of reliability and cost are developed in key areas such as energy efficiency and methane reduction. Such protocols may have application in unlocking low cost abatement possibilities in locations beyond Australia.

There is also an opportunity to use crediting arrangements as a technology driver, but this would require a crediting timeframe extending beyond the 2007 to 2011 (now potentially 2010) currently proposed.

In addition, consideration should be given to allowing credits under the scheme for funds spent on R&D, pilot and demonstration projects aimed at advancing knowledge and facilitating future abatement, although not actually abating the emissions themselves. For example, there is a Clean Coal Technology Special Agreement between ACA Low Emissions Technology Limited (ACALET) and the State to work together on developing and implementing Queensland Clean Coal Technology Projects that have the potential to facilitate substantial reductions in greenhouse gas emissions from the use of coal in Queensland and Australia. The Queensland Clean Coal Technology Special Agreement Bill 2007 obliges ACALET and the Queensland government to have the Queensland share of the ACALET levy that is spent on these projects recognised as an offset against the participating companies' obligations, if any, under an emissions trading scheme.

NATIONAL OFFSET REGISTER

The Government proposes to develop as soon as practical a national offset register to track early action credits and offsets that could be recognised under the emissions trading scheme.

Source: PMC Discussion Paper, pp. 12

BHP Billiton supports this proposal, noting prior government commitments to an abatement register, as proposed in the 'No Disadvantage-No Discrimination' Report of March 2002. BHP Billiton also notes the desirability of aligning any new Commonwealth Government register with existing or proposed arrangements at the State level (e.g. WA Greenhouse Registry and NSW Greenhouse Gas Abatement Register) with the aim of streamlining transactions and minimising the administrative burden on business.

TRANSITIONING EARLY ACTION CREDITS INTO THE NETS

It is proposed that the scheme regulator exchange early action credits for emissions permits dated for use in the first year of the scheme.

It is proposed that there be no limits on the number of early action credits that would be recognised.

It is proposed that early abatement be taken into consideration when setting the emissions caps in the initial phase of the scheme.

Source: PMC Discussion Paper, pp. 13

BHP Billiton supports full fungibility of early action credits for emission permits under the proposed emissions trading system. Such credits should also be fully transferable. However, BHP Billiton notes that the prospect of Kyoto ratification may call into question some currently proposed features of the national emissions trading system — particularly if it is to be linked into a Kyoto international emissions trading environment. One such revision might include allowance for a longer permit shelf-life, consistent with the 2012 end point for the Kyoto commitment period, and allowance for greater flexibility around the emissions trajectory in the period to 2012.

TRANSITIONING EARLY ACTION CREDITS INTO THE NETS

It is proposed that participants in the voluntary market would have access to early action credits and offsets credited for use in the emissions trading scheme.

Source: PMC Discussion Paper, pp. 14

BHP Billiton has no objection to this approach, given its consistency with a free market approach and transferability objectives.