



Mark A. Proegler

Director Environmental Policy
BP Australia

BP Australia Pty Ltd
Communications & External Affairs
360 Elizabeth Street
Melbourne Vic 3000
AUSTRALIA

Tel: +61 3 9268 3721
Fax: +61 3 9268 3426
Mobile: +61 0 424 160 238
www.bp.com.au

18 April 2008

Professor Ross Garnaut
Garnaut Climate Change Review
Level 2, 1 Treasury Place
Melbourne VIC 3002

Dear Professor Garnaut,

We are pleased for the opportunity to comment on the Garnaut Review's "Emissions Trading Scheme Discussion Paper". We view your work as an important supplement to the detailed discussions on the design of the Australia Emissions Trading Scheme, which will have a fundamental impact on the Australian economy and be precedent-setting for subsequent national emissions trading systems.

BP advocates the need for a global carbon price, and we feel that well-designed emissions trading schemes play a key role in facilitating a market response to this price signal, leading to carbon emissions reductions at least cost to the economy. However, it is important to emphasize that, while emissions trading is a necessary precondition, it is not sufficient to drive an appropriate level and rate of technology development; additional incentives will be required to facilitate investment in and deployment of large-scale, low-carbon, step-change technologies.

Yours faithfully,
BP Australia Pty Ltd

Mark A. Proegler

Attachment

BP Submittal to Garnaut Climate Change Review
Emissions Trading Discussion Paper

BP Australia has welcomed Australia's policy approach to GHG and the endorsement of emissions trading as a primary policy tool to reduce GHG emissions in Australia. We are also encouraged to see multiple sources of knowledge and input on this issue, including the National Emissions Trading Taskforce (NETT), the Task Group on Emissions Trading (TGET), the Garnaut Climate Change Review, and the collective learnings from other trading regimes around the world. Accordingly, we are pleased for the opportunity to comment on the Garnaut Review's "Emissions Trading Scheme Discussion Paper". We also wish to be actively engaged in subsequent consultation on this subject.

BP advocates the need for a global carbon price, and we feel that well-designed emissions trading schemes play a key role in facilitating a market response to this price signal, leading to carbon emissions reductions at least cost to the economy.

Moreover, emissions trading can create significant engagement with those regulated by such a scheme because they have to make conscious decisions about their emissions, leading to benefits beyond the specific scope of the trading scheme.

However, it is important to emphasize that, while emissions trading is a necessary precondition, it is not sufficient to drive an appropriate level and rate of technology development; additional incentives will be required to facilitate investment in and deployment of large-scale, low-carbon, step-change technologies.

Summary Comments

The Garnaut Emissions Trading Scheme Discussion Paper offers some new insights into the Australia ETS design—many of which BP supports. Our submittal focuses on some specific topics, noting our areas of agreement and disagreement with the Paper. In summary, this includes:

- Reiteration of key principles governing ETS design elements
- Coverage, including the inclusion of liquid fuels, which we support while noting the limitations of this approach
- Support for both direct and indirect linking with other emissions trading regimes
- Support for permit auctioning as well as administrative allocations, depending on competitive impacts and the ability to pass through costs; the refining and LNG industries are candidates for administrative allocations, at least in the near term
- Key principles for auction design
- Key principals for cost containment mechanisms, as well as examples
- Governance

ETS Principles & Design Features

BP agrees with the key principles outlined in the Discussion Paper, and we would emphasize the importance of a liquid, robust allowance market as a key factor in the emissions trading system (ETS) success and in meeting its primary objective of achieving emissions reductions at least cost. A well-functioning market and its resulting forward carbon price expectations is a particular need in the oil & gas sector, with its long development timelines and requirements of significant upfront capital investment.

A fundamental condition for a liquid market is a large number of buyers and sellers, while market integrity requires a stable and predictable regime that establishes and protects the rights of those buyers and sellers in a fair, commercially reasonable, transparent manner. While such a regime will enhance liquidity and trust in the market, liquidity cannot exist if the market is poorly designed or if the various cost-containment and structural provisions do not work together effectively as a whole. BP recommends the following measures to promote liquidity and integrity:

- Robust systems for measuring, monitoring, and reporting emissions
 - Third-party verification; transparent registries; standardised methodologies are all essential. Underpinning systems should be developed in such a way to give maximum compatibility with existing national and international tools & protocols.
- Long-term investment confidence and appropriate accountability
 - In order to promote significant (permanent) behavioral/operational changes and new technology investment, the market and regulations must provide a clear long-term framework for investment
- Compatibility with existing (and future) policies - any emissions trading program should be developed to work in harmony with existing regulations and be flexible to change as new policies and measures emerge.
- Key design features:
 - Acceptance of project based domestic and international offsets for part of compliance;
 - International linking to accept allowances from other trading regimes
 - Unlimited banking of offsets and allowances;
 - Effective multi-year compliance periods;
 - Point of regulation/obligation provisions that balance the need to match this obligation to the emitter with the costs and procedures for doing so; and
 - A well-designed compliance requirement that will support efficient trading of highly fungible allowances and offsets

ETS Key Design Elements

Coverage BP believes in principal with the Paper's recommendations to cover as many gases and sectors as possible. However, there are other factors to consider:

Gases: the appropriateness of applying emissions trading to each of the Kyoto greenhouse gases needs to be evaluated separately for each gas. For more “specialised” gases it is likely that the transaction costs and complexity associated with their inclusion may outweigh the benefits. Alternative policy measures should be considered in this case.

Sectors: the Paper recommends the inclusion of all industrial sectors, which BP supports since we believe it is important that all sectors of the economy should contribute equitably to national goals to reduce greenhouse gas emissions. While we understand the importance of including the transport (liquid fuel) sector in the cap, this will have limited environmental effectiveness given the relatively small impact that resulting fuel price rises will have on fuel demand and on the choice of new motor vehicles. Significant emissions reductions in this sector will only be achieved via an integrated policy approach that addresses vehicle efficiency, fuel carbon content, and consumer behavior—the latter comprising a range of actions across many time scales, including traffic management, road pricing, city planning, etc.

Linking Connecting the Australia emissions trading system with other existing systems expands the potential for economic gains from trade and associated cost savings—whether this comes from direct linking (allowances) or indirect linking (linking via the inclusion of international offsets that are accepted in multiple trading systems, e.g. CDM, JI). Larger and more liquid markets are inherently more efficient, reducing transactions costs and providing capital for a larger pool of opportunities for low cost abatement.

Direct Linking In general, linking with other systems will be accomplished more easily if the elements in each system are similar, which is an important consideration in the design phase of the ETS. For example, monitoring requirements across systems need not be identical in every way, but they need to be accepted as comparable in rigor by companies and governments; the use of common protocols (e.g. WRI/WBCSD GHG Protocol) will help facilitate this. Transparency and public access to emissions data are also essential design features in building acceptance of the program and associated monitoring requirements. Key criteria in evaluating the direct linking of programs should include the consideration of:

- Environmental integrity, specifically the potential to expand environmental benefits compared with the absence of linking
- Cost effectiveness, including the potential for lower (or higher) costs in linked systems compared to systems that operate independently
- Fairness to all participants

Indirect Linking The linkage of trading systems via offsets such as CDM and JI also offers advantages¹, and is more likely to occur in the near term than direct linking. Accordingly, it is important that the ETS provides for unfettered inclusion of offsets such as CDM and JI. BP does not support the Paper’s recommendation that CDM credits accepted by the ETS be limited based on their country of origin.

¹ “Linking Emissions Trading Systems” Policy Brief, IETA, Andrei Marcu, October, 2007

Allowance Allocation BP fully agrees with the Paper's statement that "The most important point is that the impact of an ETS on the price of goods and services is *independent* of the approach adopted by governments for allocating permits". However, because permits have economic value, the chosen allocation method (e.g. administratively allocated or purchased/auctioned) will determine how this economic impact is distributed amongst regulated entities, consumers, and other parties—and this will have significant consequences, especially given the billions of dollars involved in the Australia ETS. The allowance framework will accordingly play a key role in meeting political, economic, and technology objectives.

An emission allowance allocation system should seek to mitigate economic transition costs to entities that will be relatively more adversely affected by GHG emission limits or that have already made investments in higher cost, low-GHG technologies, while simultaneously encouraging the transition from older, higher-emitting technologies to newer, lower-emitting technologies.

The purpose of allocation is to initiate a market for carbon on an efficient and equitable basis, rather than to create an indirect tax and revenue source for government. BP recommends that Australia should distribute allowances in a manner consistent with achieving fundamental objectives of cost-effectiveness, fairness, transparency, and simplicity. Additional guiding principles include:

- Mitigates economic impacts caused by competition from firms operating with no "carbon constraint"
- Reflects the capacity of different sectors to recover costs through the inclusion of carbon in product pricing
- Avoids perverse incentives that discourage or penalise investments in low-GHG technologies and fuels
- Helps to ensure market liquidity
- Minimises administrative complexity and maximises transparency regarding the use of allowance value

For sectors that can fully pass through costs and are not exposed to competition not subject to a carbon price, permits should be distributed via full auctioning.

For sectors that face challenges from competition not exposed to a carbon price and who are unable to pass on increased costs of carbon constraints, some administrative allocation, phased out over time, should be used to help manage the transition to full auctioning.

Examples of BP businesses exposed to an international carbon price with very limited ability to pass through costs— and therefore candidates for administrative allocation of permits—include our activities in petroleum refining and LNG production and export.

Auction Design Auctioning should be seen as a way to allocate carbon into the market and allow it to operate—not as a tool to manage the market. Key principles for auction design include transparency, simplicity, scale, and timing.

Auctioning Revenue Given that the primary objective of an emissions trading system is to achieve cost-effective emissions reduction, any revenues from auctioning of permits should be used primarily for this purpose, and returned back to the private sector through some form of recycling. This revenue should be used primarily to support the development and deployment of low-GHG technologies,

such as carbon capture and storage (CCS). In addition, the processes for managing these revenues and their distribution should be proscriptive and transparent.

Cost Containment Mechanisms The need for explicit cost containment measures may be especially important during the initial years of a cap-and-trade program while the development and deployment of low-carbon technology may lag behind the level needed to achieve mandated emission reductions targets and commercially available financial tools and strategies for managing volatility and risk are not fully developed.

In addressing this need, BP believes that explicit cost containment measures should be based on the following principles:

- Measures should be clear, effective and easy to administer;
- They should not breach the legislation's overall GHG emission cap and ensure that needed reductions are achieved in a timely manner;
- They should, to the maximum extent possible, provide objective, clear and predictable information about the factors influencing future allowance prices;
- They should not supplant the development of commercially available financial tools and strategies for managing volatility and risk;
- They should minimise the opportunity for intentional manipulation of market prices by market participants;
- The application of many of the measures should diminish over time, so that cost-minimising market forces can properly spur investment in the most cost efficient, long-term solutions for reducing GHG emissions

Cost containment measures should be designed to address a variety of reasonable concerns about the price and cost impacts of a cap-and-trade system. The primary concerns are threefold: a) short term extreme price volatility; b) sustained high allowance prices, an allowance price trajectory that discourages important investments in emissions-reducing technologies; and c) illiquidity. All of these problems can be guarded against, to some degree, by allowing a sufficient amount of qualified project-based offsets to qualify for compliance purposes. In further addressing these concerns, it is important to use well-considered tools that can be relied upon to effectively mitigate these concerns and that will work well together while being consistent with the principles above. BP recommends the following package of tools which could be used in various combinations to deal with the key concerns:

- Acceptance of project based domestic and international offsets for part of compliance;
- Acceptance of international allowances for compliance from countries with capped emissions;
- Unlimited banking of offsets and allowances;
- Effective multi-year compliance periods

Governance

While the foundation of a successful trading program includes a rigorous system for collecting and reporting accurate emissions data, its effective operation is dependent on the market's ability to function with integrity and minimal government interference.

The Paper suggests the creation of an Independent Carbon Bank (ICB) to oversee the operation and administration of the Australia ETS. While BP agrees in concept with an independent regulator (leading to effective hypothecation of (auction) revenue), there are concerns that the ICB possesses the capacity to act as both regulator and market participant, which would undermine confidence in the market. The government's market design elements (cap, banking provisions, offset use, etc.) should be the primary levers to influence market price—not direct intervention by an entity like the ICB.