Carbon Update

This is the first in a series of updates for the Australian mining industry on the carbon price debate.

1 Who needs to know?

Mining companies with Australia operations will face increased costs under a carbon price.

2 What is proposed?

The Gillard Government has released initial details of its plan for a carbon price from 1 July 2012:

- An initial fixed price, to be announced. Expected to be $20-30/t CO2equivalent, with fixed annual increase (potentially 4%+CPI pa).
- Transition to emissions trading within three to five years. The price would be unrestricted, set by the market. Some expect a $40–$45/t CO2e starting price.
- Broad coverage of emissions sources, including stationary energy (power stations), transport, industrial processes, fugitive emissions (emissions escaping from oil and gas extraction and processing, from gas pipelines and from coal mines, but decommissioned coal mines will be excluded) and 'non-legacy' waste. Sectors could be phased in.
- International credits will not be permissible during the fixed price phase, but could be used in the ETS phase. It is likely domestic offsets will be accepted at all times.

Details are yet to be released of:

- the starting price;
- industry, community and household assistance, and
- support for low emissions technology and innovation.

3 Will it happen?

The carbon price has generated considerable public and media discussion.

The design details are being discussed by the Government's Multi Party Climate Change Committee and at business and environmental/community group roundtables. The Government intends to pass legislation in the third quarter of 2011.

For any legislation to be passed the Government will need the support of either:

- the Coalition (which is vocally opposing the proposal); or
- the Greens (who demand strong climate action, opposing large industry compensation) and key independents. On the current parliamentary numbers this looks likely.

The failed 2009 Carbon Pollution Reduction Scheme experience shows this will not be a simple or predictable process.

If the Government's current proposal does not progress then there will be considerable uncertainty for the future regulation of carbon in Australia.

4 What does it mean?

A carbon price will increase the cost of activities that directly or indirectly (ie through their inputs) emit greenhouse gas emissions. For mining projects the key carbon costs will attach to gas, coal, diesel and electricity use. Coal mines may also face costs for their own direct methane emissions.

The following is an example of the potential annual emissions and costs of a regional medium sized open pit mine, using excavators and trucks for mining, with associated processing.

Activity	Emissions (t CO2e)
Onsite electricity generation, from 15,000kL diesel	40,500
Mining vehicles, 3,000 kL diesel	8,250
Onsite vehicles, 3,000 kL diesel	8,250

Activity	Emissions (t CO2e)
Materials transport, 3,000 kL diesel	8,250
Staff fly in fly out (120 round 2 hour trips per year)	500
Explosives	12
Wastes	600
Total annual emissions	66,362

The mining company will likely be required to acquire and surrender permits for its major direct emissions, primarily the electricity generation.

For vehicle fuel use the mining company will either be passed the cost by its fuel suppliers, or the mining company may be able to itself assume the direct liability to acquire and surrender permits.

While the mining company will not itself have an obligation to acquire and surrender permits for its indirect emissions (incurred by others), it will likely be passed the cost. Therefore the mining company's commercial exposure is best calculated on the basis of its total emissions profile.

The following table shows potential annual costs based on the total emissions, at indicative possible carbon prices of \$20, \$25, \$30 and \$45/t CO2e, and with no, 60% or 90% compensation.

Carbon price	No compensation	60% compensation	90% compensation
20	\$1,327,240	\$530,896	\$132,724
25	\$1,659,050	\$663,620	\$165,905
30	\$1,990,860	\$796,344	\$199,086
45	\$2,986,290	\$1,194,516	\$298,629

This is a rough indicative example only. We are waiting on the final details to be able to effectively determine the likely price impacts on operations, especially the carbon price and compensation arrangements. But the example shows it is reasonable to assume that the exposure for mining companies could be substantial and potentially material.
Your ability to manage carbon price cost increases will depend on:

- The final form of the carbon price, including any industry compensation. While it is being debated, many expect the industry compensation to be similar to the CPRS proposals. This would still leave qualifying businesses with a considerable exposure. Many mining sectors are unlikely to receive any compensation. The coal mining sector with its methane gas emissions faces unique issues.
- Which entity in a corporate group the legislation makes liable and their ability to transfer that liability if necessary.
- The legislation's rules regarding joint ventures. It is assumed the liability will rest with the operator and joint venture parties must then separately manage those costs commercially.
- Your contractual arrangements in place for the pass through of carbon costs.
- Your ability to use lower emission and more energy efficient practices.
- Your ability to access competitively priced offset credits. The Government's proposed Carbon Farming Initiative may provide a source of domestic offsets.

5 What should you do?

(a) Review and design contracts: It is important to review and design your contractual arrangements to best manage carbon costs. This is generally achieved where all parties accept appropriate pass through. You should always consider where emissions (and therefore costs and risks) are likely to arise and how they can be best managed.

(b) Offsets: Carbon offsets may be one key way to manage carbon costs. The proposed 'Carbon Farming Initiative' voluntary scheme will likely lay the framework and, with its planned 1 July 2011 start date, will allow trial preparation for the mandatory carbon price. For CFI scheme information, see our article 'New carbon legislation released'.

(c) Disclosure: Be careful what statements you are making publicly and in your financial documents. The likelihood of a carbon price should be considered.

(d) Approvals: If you are going through an approval process, any carbon offset proposals or negotiations should be revisited.

We would be happy to meet with you to discuss the implications for your business, please contact us to arrange.

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