



Minimising emissions and avoiding omissions: Your strategy for thriving in a CPRS-era

In this GerrardBown update, we take a step back from the hype surrounding emissions trading, and consider where the Carbon Pollution Reduction Scheme (CPRS) fits within the Commonwealth Government's broader strategic response to climate change. In addition, we outline some of the key issues your business should consider in developing a strategy to address the impacts of the CPRS, climate change and a carbon-constrained business environment.

In a stance reminiscent of the 15th century view that our earth is flat, many organisations underestimate, or at worst deny the economic impacts of climate change. In this client update GerrardBown outlines the importance and commercial advantage of round-world thinking in a carbon constrained era.

Australia will have a Carbon Pollution Reduction Scheme in 19 months. The scheme will change company cost structures, industry dynamics and organisational value. It is already posing numerous challenges and offering opportunities to businesses around the nation.

It is clear that we are currently in the midst of a highly volatile period brought about by challenging economic conditions, climate change and tougher legislative conditions. Organisations

that do not respond to these changes are likely to face a turbulent future. For those that lead the change the current epoch presents an opportunity to secure strategic advantage and prosperity through innovation and positive impact. Is your organisation equipped to prosper in a CPRS-era?

Australia is highly exposed to the global crisis

The world is in the midst of ecological and financial crises. There is consensus in the Australian and international scientific communities that human action over the last century has led to global warming, and consequently, climate change. Increases in temperature due to climate change pose a significant threat to Australia's human and economic wellbeing and general quality of life.

The direct impacts of climate change on Australian businesses are likely to be substantial. In particular, climate change and consequent regulatory responses will result in new or higher costs for inputs such as insurance, capital, energy, water and raw materials. There is a growing legislative and social push for business to use fewer resources and lessen their environmental impact. As a result, businesses are integrating sustainability criteria into purchasing decisions and supply agreements. This has resulted in carbon consciousness being pushed down supply chains.

In terms of listed companies, investors may put a higher risk premium on companies which are not seen to be responding pro-actively to climate change. This could significantly alter the way these companies are valued. Heightened awareness of the problems of climate change has also ushered in a wave of consumer demand for environmentally friendly products and services.

Concurrent with this ecological crisis, business is also facing economic uncertainty due to the recent turmoil of the financial markets. The combination of these two crises presents an opportune time for organisations to re-assess their business planning to ensure they are operating sustainably, a strategic objective which instills resilience during times of environmental and financial calamity. Climate change and



carbon trading remain pressing issues and businesses would be commercially unwise not to act on them - even in these troubled financial times. In fact, evidence suggests it is innovation and new technology that is a key component for moving down the path to economic recovery.

The Government's strategy is to mitigate, adapt and engage

The Australian Government has adopted a strategy to respond to climate change that comprises three key 'pillars': mitigation, adaptation and international engagement. The object of the mitigation pillar is to reduce the ultimate extent of climate change and its impacts. This pillar is underpinned by a goal of reducing greenhouse gas emissions by 60 per cent below 2000 levels by 2050. Adaptation is focussed on adjusting responses to climate change so as to moderate harm and exploit beneficial opportunities. Examples of the adaptation pillar include the \$200 million Great Barrier Reef Rescue Plan and the long term \$12.9 billion Water for the Future plan. The third pillar, international engagement, is concerned with partnering with other nations to (a) take action to address climate change, and (b) facilitate transfer or investment in greenhouse technologies, products and expertise between Australia and partner countries. This innovation is also furthered by funding schemes to develop 'green' technology, such as the Commonwealth Government's Renewable Energy Equity Fund (REEF). REEF provides venture capital and managerial advice for small, innovative renewable energy companies.

The CPRS is at the forefront of the Government's mitigation strategy

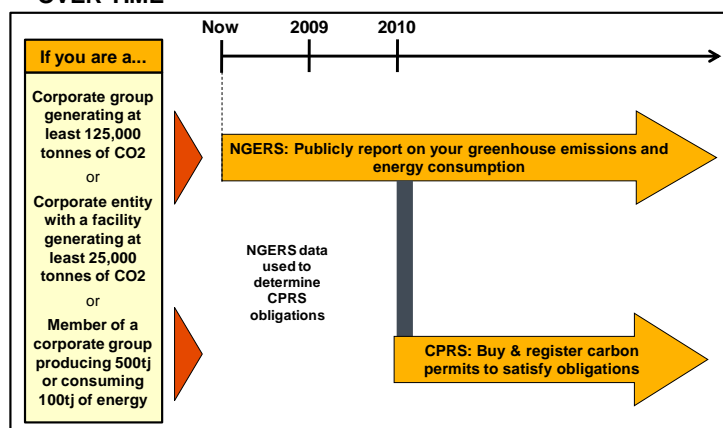
The emissions generated by human activities are a major contributing factor to climate change. Due to our reliance on coal for electricity generation and our resource-driven economy, Australia's per capita emissions are among the highest in the world.

To date, the market has failed to factor the environmental impact of producing goods and services into their end price. As Professor Garnaut points out, the effect of a robust CPRS

will be to make households and businesses take primary responsibility for the maintenance of their livelihoods and the things they value and purchase. Even businesses generating less than the CPRS threshold of 25,000 tonnes of carbon per annum will be impacted as CPRS-liable businesses pass on the cost of carbon to their customers through higher prices. Consequently, households and businesses will have a financial incentive to purchase low-carbon goods and services.

Although the primary focus of this update is on the CPRS, it is important to note that as of July 2008 many companies are already subject to the substantial requirements of the National Greenhouse Emissions Reporting System (NGERS). NGERS is a mandatory framework that aims to provide a robust national emissions and energy reporting system for the CPRS.

DIAGRAM 1: OBLIGATIONS UNDER NGERS AND CPRS OVER TIME



The CPRS attempts to correct the market failure in the following way:

- I. The Government sets a cap on the total amount of carbon pollution allowed in the economy by covered sectors (see point II below) and a mandatory threshold up to which organisations may emit without purchasing permits.
- II. Only companies that directly emit are likely to be covered by the CPRS. The relevant covered sectors include stationary energy, transport, fugitive



emissions, industrial processes, waste, reforestation (on an opt-in basis) and most likely agriculture (though not before 2015). The total threshold for liable organisations will be 25,000 tonnes of CO² emitted.

- III. Entities with operational control over a facility or activity must either reduce their emissions below the mandated threshold or acquire 'permits' for the **entire quantity** of greenhouse gas that they emit in that year (quantities of which are monitored and verified).
- IV. Initial estimates project a carbon permit price of between \$20 and \$40 per tonne.
- V. Firms purchase permits at an auction or in a secondary-trading market which will allow the forces of demand and supply to set price levels. Certain categories of firms may obtain some permits for free or other forms of assistance. These firms could use these permits or sell them on the market.

Developments in this area are moving very quickly. However, ambiguities remain around issues such as the relationship between the voluntary carbon market¹ and the CPRS. Similarly, it is not clear how the CPRS will interact with existing state-based schemes. In December 2008, the Commonwealth Government's Department of Climate Change plans to release a white paper with draft legislation to implement the CPRS.

The latest Commonwealth Treasury modeling reveals that early action to mitigate the effects of climate change at a national level is less expensive than later action. The same can be said at an organisational level as organisations consider how and when to respond to the CPRS. Earlier action will be rewarded by greater competitiveness and long term prosperity.

¹ Includes all purchases of carbon permits that are on a voluntary (eg not required by the CPRS) basis.

Climate change and the government's strategic response create risk and opportunity for your business

"Tactics without strategy is the noise before defeat." - General Sun Tzu

It is clear that during challenging periods such as the impending CPRS-era, organisations which operate strategically will survive and prosper, while those who do not, will fail. The wrong approach could lead to higher costs, higher risk and impair competitive positioning. Despite this, a recent survey of over 250 CEOs, senior managers and business owners by the Australian Institute of Management revealed that eight per cent of all respondents had no knowledge of the CPRS and 80% stated they had only some or little knowledge of the CPRS. Is your organisation staffed by such people?

The introduction of the CPRS raises important questions for your organisation, such as:

1. Do you understand your current obligations under NGERS and your likely obligations under the CPRS? Are you equipped to meet them?
2. Do you have a carbon strategy and if so, do all of your senior managers understand what it is?
3. Do you know your carbon exposure and the key opportunities to decrease it?
4. Do you know how the carbon price will impact your cost base and the value of your business?
5. Have you considered the risk posed by a carbon price to your business? In particular, a recent finding by the Commonwealth Treasury outlines that the CPRS will cause a shift in demand from emission-intensive products towards lower-emission products. What type of business is yours? Is this a risk for your business?
6. Do you have appropriate risk mitigation strategies in place?
7. Is your carbon strategy embedded in your corporate governance framework?
8. Are your stakeholders assured that you are acting effectively in response to the CPRS?
9. Has your organisation systematically identified the revenue opportunities which



may arise from the predicted growth in low-emission goods, services, technologies and processes?

10. How will the cost of your supplies be impacted by carbon trading and increasing resource prices over the next 5 years?

advantage of new opportunities and achieve future prosperity.

For further information on the CPRS and how GerrardBown can assist your business, please contact Samuel Redmond, Business Development Manager, on + 61 3 9001 1578.

Taking a strategic approach is essential

Developing a strategy which will enable your business to prosper in a carbon-regulated economy requires detailed thinking and organisation. Businesses must assess the external landscape, the cost implications and revenue opportunities and the operational implications. There is no simple answer to how a company should achieve its carbon reduction goals. Many organisations purchase external offsets instead of implementing internal measures to reduce emissions. In doing so they may have bought carbon credits that do not deliver the reductions claimed and/or might not be recognised under the CPRS. They may also face criticism from the public and environmental lobby groups for paying their way out of acting responsibly and would miss out on the learning and cost savings associated with process and technological improvements.

There will be a distinct shift in Australia's competitive advantage in a low-emission world. According to the latest Commonwealth Treasury modeling, this shift presents new opportunities, which, if met with global co-ordinated action, will allow our economy to grow. GerrardBown can guide your organisation to meet the many challenges and exploit the new opportunities on the carbon-constrained horizon.

Sneak preview of the next Gerrard Bown Update

In the next GerrardBown update, we question the temptation to implement traditional short-term cost-cutting solutions during uncertain economic times. Unfortunately, recent history has shown that short-term solutions often create even bigger problems in the longer term. Innovative strategies that build organisational resilience will help to ensure that your organisation survives the current crisis while remaining in a position to take