Hydro Tasmania
the renewable energy business

19 December 2006

Ms Anthea Harris
National Emissions Trading Taskforce Secretariat
The Cabinet Office
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SYDNEY NSW 2001
Email submissions@emissionstrading.net,au

Dear Ms Harris

**Re: Discussion paper - *Possible Design for a National Greenhouse Gas Emissions Trading Scheme***

Thank you for the opportunity to provide comment on the National Emissions Trading Taskforce's Discussion Paper, *Possible Design for a National Greenhouse Gas Emissions Trading Scheme.* Please find enclosed Hydro Tasmania's submission in response to the propositions and issues identified within the Discussion Paper.

We welcome the opportunity to provide the Taskforce with further information about the contents of this submission or any other issues. Should you have any queries or require further information, please contact Corinna Woolford on (03) 6230 5636 or email corinna.woolford@hydro.com.au.

Yours sincerely

P. G. Lennon

Pat Lennon
General Manager Business Development

# NATIONAL EMISSIONS TRADING TASKFORCE DISCUSSION PAPER

## *POSSIBLE DESIGN FOR A NATIONAL GREENHOUSE GAS EMISSIONS TRADING SCHEME*

## Hydro Tasmania Submission

## Introduction

Hydro Tasmania is the pre-eminent renewable energy generator in Australia, producing approximately 60% of Australia's renewable energy, and is internationally recognised for its expertise in sustainable hydro power production.

Hydro Tasmania strongly supports the introduction of a national emissions trading scheme (NETS) in Australia, and commends the work undertaken by the States and Territories in developing the Discussion Paper, *Possible Designs for a National Greenhouse Gas Emissions Trading Scheme.* We are also encouraged by the recent announcement of a Prime Ministerial Task Group on emissions trading, and look forward to a possible national approach to this issue in the coming year.

Hydro Tasmania believes that for a NETS to be truly successful in reducing Australia's greenhouse gas emissions, it should commence with full auctioning, no free allocation and a stringent cap. However, we acknowledge that the reality is that some concessions for implementation will be required in order to ease the initial burden on industry and the national economy.

With this in mind, this submission comprises Hydro Tasmania's views on a number of the propositions and issues raised in the Discussion Paper. All comments in our submission are grouped under the appropriate chapter heading. Key issues include the following:

- there is a need for a stringent cap in order to drive significant emissions reductions and encourage uptake of low emissions and renewable energy technologies;
- the proposal to expand coverage after five years is supported;
- banking should not be restricted and borrowing should not be allowed;
- the penalty should be set higher than the marginal cost of technically and commercially viable abatement, but should not be punitive;
- the use of Certified Emissions Reductions (CERs) as offsets should be approached with caution;
- a combination of auctioning and allocation should be used to facilitate emissions abatement, with a transition to full auctioning as soon as possible after the scheme's commencement;

- there should be further exploration of how the permit allocation process could proactively facilitate investment in low emissions technologies, including retention of existing ageing renewable assets and increased deployment of new renewable energy;

- allocation to existing generators should be linked to emissions intensity rather than profit, as profit forecasts are very difficult;

- any net contributions received through the permit auctioning process or from the penalty should be deployed to support the development and commercialisation of existing and new renewable and low emissions technology industries in Australia, as well as the renewal and expansion of existing low/zero emissions assets. A grant program to provide support to new and emerging low and zero emission technologies could be supported in this manner;

- the Mandatory Renewable Energy Target (MRET), Victorian Renewable Energy Target (VRET) and other initiatives are essential to encourage early uptake of low/zero emissions technologies, and should operate in parallel with the scheme; and

- there are a number of issues with the modelling presented in the Discussion Paper that should be addressed.

## 1. The need for action

***Stakeholder views are sought on developing policy that places Australia on a path towards reducing national greenhouse gas emissions by around 60% compared to 2000 levels by the middle of the century.***

Hydro Tasmania acknowledges that action is required now to achieve deep cuts in Australia's emissions profile. If the primary objective is to place Australia on a long term glide path to a lower carbon intensity economy, the design of the scheme and the cap for the stationary energy sector must reflect this imperative.

As noted in our November 2005 submission to the Taskforce on the Background Paper, *A National Emissions Trading Scheme*, a NETS should take into account:

- the present findings of climate change science, and the imperatives they present;

- the level of emissions reduction required for Australia to compete in a low carbon intensity world;

- the quantum of abatement achievable with current technologies;

- the timing for commercialisation of emerging and new low emissions technologies; and

- the commercial impact a NETS would have on the Australian economy.

Recent reports, most notably the Stern Review[1], provide impetus for immediate action to reduce emissions and avoid dangerous climate change. The Stern Review reveals that the economic costs associated with the impacts of climate change are estimated at 5% of GDP by 2050 (though this could rise to 20% under the worst case scenarios). To avoid these costs, the Stern Review suggests emission stabilisation at 450 to 550 ppm $CO_2$ to limit temperature rise to 2 to 3º C, and requiring global emissions to peak within the next 10 to 20 years and then fall progressively.

This is similar to the findings of recent modelling undertaken for the Australian Business Roundtable on Climate Change, which likewise revealed that delaying action for just nine years has a significant negative impact with the necessary deep cuts being achieved but on a steeper trajectory from 2022 which in turn limits GDP growth to an average 1.9% pa over the period to 2050.[2]

The Energy Futures Forum, initiated by the CSIRO, has also recently released a report illustrating the positive impact of early action in an Australian context.[3]

***State and Territory Governments invite the Commonwealth Government to join with them in considering the scheme design set out in the discussion paper.***

As the Taskforce would be aware, Prime Minister Howard announced on 10 December 2006 the Terms of Reference and membership of a Prime Ministerial Task Group on emissions trading.

Hydro Tasmania welcomes this announcement and encourages the Task Group to consider the work done to date by the NETS Taskforce, as well as to examine and assess the relevance and appropriateness of existing ETS designs including the European Union Emissions Trading Scheme (EU ETS) and the McKibbin-Wilcoxen Blueprint.

## 2. Coverage

***It is proposed that the scheme's coverage commences with:***

- ***initial coverage of electricity generators only, where those generators have a capacity of 30 MWe nameplate rated electrical output capacity or more; then***

- ***expansion of coverage five years after scheme commencement to include other stationary energy sources which emit more than 25 kt***

[1] http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm

[2] The Australian Business Roundtable on Climate Change (2006). *The Business Case for Early Action.*

[3] CSIRO (2006). *The heat is on: the future of energy in Australia*.

***$CO_2$-e a year from stationary combustion of gas, oil, coal and other fossil fuels.***

***(An alternative coverage option is to include, from the time of scheme commencement, all facilities (including electricity generators) emitting more than 25 kt CO2-e a year from stationary combustion of gas, oil, coal and other fossil fuels.)***

Hydro Tasmania's supports the proposal that the principle point of liability should be at the source of emissions. This will ensure direct impact of the scheme in investment decisions and abatement action that will ultimately lead to least cost abatement.

Hydro Tasmania supports the proposed expansion of coverage after five years of operation. To be fully effective in achieving the necessary emissions reductions, the ETS must expand coverage and provide incentive for investment and behavioural change across the entire economy and not be limited to just stationary energy sector.

***Comment is sought on the proposal that an aggregation rule be included in the scheme to avoid incentives to circumvent coverage.***

Hydro Tasmania supports the adoption of an aggregation rule, as has been adopted by the EU ETS. Simplicity in rule design is important to ensure the intended outcome (avoiding perverse incentives) is achieved and that commercial business decisions are not otherwise constrained.

***It is proposed that the NETS cover all six gases under the Kyoto Protocol***

Hydro Tasmania supports the intent to cover all six greenhouse gases under the Kyoto Protocol.

***It is proposed that fixed dates for inclusion of emissions, and cap levels, be specified in scheme legislation for emissions from stationary combustion of gas, coal, oil and other fossil fuels (excluding emissions from petroleum refineries).***

***For sectors other than stationary energy, it is proposed that a specified process be adopted that must be adhered to before the scope is widened. This should include a minimum period of notice (for example, 5 years) that must be given before new activities or sectors are added.***

Hydro Tasmania supports the considered and timely expansion of the scheme to ensure that the scheme continues to deliver least cost economy wide emissions abatement. A transparent timetable for expanding the coverage of the scheme is essential for industry certainty. This timetable must balance the growing need (in line with emerging scientific evidence of the impact of climate change) for economy wide emission reductions with the dangers associated with an overly aggressive scheme introduction and expansion. An early signal will also help the cultural change which is needed to change public perception of greenhouse.

## 3. Scheme cap

***It is proposed that firm annual caps be set for the first 10 years of the scheme (eg 2010-19) and a range of possible future caps ('gateways') for the following decade (eg 2020-29). Following the proposed commencement of the scheme governments would announce a firm cap for an additional year (within the bounds of the gateway) on a rolling annual basis, so that there would always be 10 years of firm caps. Every five years, gateways would be updated and extended by a further five years.***

Hydro Tasmania supports the approach of setting firm annual caps for the first 10 years of the scheme provided that:

- the cap is set at an appropriately high level; and
- a review mechanism is incorporated, whereby the caps can be revised upwards if required.

Such an approach will provide significant industry certainty, whilst maintaining the opportunity to revise the cap upwards in later years.

With regard to the gateways, Hydro Tasmania supports this approach provided that an appropriately high cap is covered by the lower bound of the gateways and that the gateways are regularly reviewed to ensure their validity is retained. We would not support any proposal to allow downwards revision of the gateways. This would also support industry certainty.

***Stakeholder comment is sought on:***

- ***The appropriateness of firm annual scheme caps for electricity generation emissions within the bounds of Scenarios 1 and 2 during 2010-19***
- ***The appropriateness of Scenarios 1 and 2 as the basis for potential upper and lower gateways, respectively, for electricity generation emissions during the period 2020-29***

As stated in our November 2005 submission on the NETS Background Paper:

> *"The establishment of the emissions cap is the most significant design element of the Scheme.*
>
> *If the primary objective of the NETS is to place Australia on a long-term glide path to a lower carbon intensity economy, the cap for the stationary energy sector must reflect this imperative.*
>
> *The emissions cap must therefore reflect a national commitment to achieve significant emissions reduction by the middle of the century."*

Hydro Tasmania maintains that the cap should be carefully considered and that a range of caps should be considered, rather than just two as presented in the Discussion Paper. Stringent caps are a preferable long term outcome in terms of emissions abatement, and should be modelled to provide a more informed assessment of potential costs and benefits.

Furthermore, we understand that the modelling work has yet to be refined (refer comments on Chapter 6), and therefore the true impact of the targets presented in the Discussion Paper have yet to be determined. Hydro Tasmania believes that comment on these targets is premature as the modelling does not yet give a complete picture of what the real impact of these caps will be.

***Stakeholder comment is sought on the proposed approach to adjust the scheme cap to include additional sectors***

As outlined in our response to Chapter 2, Hydro Tasmania supports the proposal of including additional sectors within the scheme. It is important that other sectors be included as soon as possible in order to promote industry certainty and minimise costs by introducing them in the early years of the scheme when permit prices are likely to be lower. However, if the scheme is to be expanded, it is important that the cap is adjusted accordingly to reflect the additional emissions covered and to ensure that the overall level of abatement is not diluted.

***It is proposed that:***

- ***Banking should be unrestricted (although comment is sought on whether any limits on banking, such as banking in 10-year blocks, would be desirable.***

- ***No borrowing should be allowed.***

Hydro Tasmania agrees with the proposal to make banking unrestricted under the NETS.

Hydro Tasmania agrees also that no future borrowing should be allowed under the scheme. This will ensure that companies are made accountable for their emissions in a given year.

**4. Penalty and make-good provision**

***It is proposed that:***

- ***the penalty should be set a level that caps the cost of the scheme at an acceptable level but also encourages compliance; and***

- ***a civil penalty should be applied for non-compliance.***

Hydro Tasmania believes that the penalty must be set at a level that:

- encourages compliance, without broad detrimental impacts on the economy;

- caps the maximum impact of the scheme on industry participants, while also encouraging technically and commercially viable abatement; and

- enables achievement of the overall emissions reductions target.

We submit that the penalty should be set higher than the marginal cost of technically and commercially viable abatement, but should not be punitive. As noted in our November 2005 submission, the success of the scheme in achieving its target will require the ability of low/zero emissions technologies to be technically and commercially viable within the carbon price range implied by the penalty. It is therefore important that the cost of these abatement technologies is carefully considered when setting the penalty.

Hydro Tasmania also submits that the penalty should be non tax-deductible in order to facilitate compliance.

Hydro Tasmania supports the introduction of a civil penalty for non-compliance.

***It is proposed that the scheme should not include a make-good provision.***

Hydro Tasmania agrees with the proposal not to include a make-good provision, provided that the penalty is set at a level sufficient to drive compliance and any funds raised from the penalty are used to drive emissions reductions.

If these prerequisites do not occur, Hydro Tasmania submits that a make good provision will be required to ensure credibility of the scheme in achieving its greenhouse gas abatement targets. While a make good provision can result in additional cost should emitters not meet their targets, it is a further and necessary disincentive that will ensure emitters do not simply opt out of delivering abatement.

## 5. Offsets

***It is proposed that credits from CDM projects (known as CERs) be recognised as equivalent to offset credits under the NETS. Comment is sought on whether limits should be placed on the volume of CERs recognised as equivalent to offset credits, and the implications of such limits.***

Hydro Tasmania has concerns regarding the proposal to use CERs as offsets under the NETS. Specifically, we are concerned that this approach is encouraging liable parties to invest in overseas renewable energy projects instead of new renewable energy projects in Australia. Australia, as one of the largest per capita emitters in the world, should give priority to developing its own large renewable energy potential.

If CERs are to be used as offsets, Hydro Tasmania submits that a limit should be placed on the volume of CERs allowed as offsets and that Australian renewable energy projects should simultaneously be eligible as offsets. This will ensure that investment in renewable energy offsets occurs within Australia where the abatement is required. Furthermore, only projects fully approved by

the CDM board should be allowed to ensure that stringent additionality requirements are met.

## 6. Estimated impacts of addressing greenhouse gas emissions through the NETS

***Stakeholder comment is sought on the electricity sector and economy-wide modelling assumptions, methodology and results.***

Period covered by the modelling

The modelling presented within the discussion paper covers the period 2010-2030. Hydro Tasmania submits that the modelling must provide analysis of the scheme impacts on the objective to achieve long term cuts in greenhouse gas emissions at least to 2050. Modelling should look at what is required to meet this long term target, not just a mid range target of 2030.

In particular, we note that beyond 2030, without an extension of the MRET and a sufficient rise in the pool price, there could be significant decommissioning of ageing hydro assets or wind projects that are reaching their end of life. If these assets are replaced by alternate higher emission sources such as gas, Australia's emissions profile is likely to increase rather than the decrease. It is therefore important that possible scenarios beyond 2030 are examined to ensure that an appropriate cap and design mechanisms are put in place to ensure that such an outcome does not occur.

The Victorian Renewable Energy Target (VRET) has not been included in the modelling

As the VRET has now been legislated, the modelling should consider the likely impact of VRET (and potentially the proposed NSW Renewable Energy Target) on the NETS.

The modelling assumes that the wholesale electricity price results in an increase in retail prices at all levels (residential, commercial, industrial customers)

This is not necessarily a correct assumption. The modelling should consider the extent to which contractual arrangements may exclude, limit or delay the pass-through of these cost increases to end-use customers.

The modelling assumes minimal emissions abatement between 2010-2030

The modelling reveals that with a low cap, minimal emission reduction is achieved in the early years of the scheme. While Hydro Tasmania acknowledges the need for a managed introduction and expansion of the NETS, this must be balanced with the need to achieve immediate emissions abatement and transitioning of the Australian economy toward a low carbon future.

As detailed in our response to Chapter 1, Hydro Tasmania recommends that the Taskforce examines the Stern Review and the implications of its recommendations for the proposed NETS and abatement timeframe.

The modelling concludes that an energy price of $43 to 44 is sufficient to deliver substantial increases in renewable energy generation post 2020 – despite no other new measures being assumed

It is reasonable to assume that the cost of deploying proven renewable energy technologies is declining as a result of learning, increased scale and technological advance. However, without some other additional support measure, it is unlikely that energy prices of $43-$44 will alone be sufficient to provide sufficient incentive for the large scale deployment of renewable energy technologies.

We therefore strongly urge the Taskforce to re-examine the modelling's assumptions/conclusion that significant new renewables will be developed as a result of the scheme.

The cost of wind generation is projected to fall sharply over the next decade

Significant demand growth in renewable energy has already occurred within the region and globally. This is likely to continue to occur as countries like China and India legislate ambitious renewable energy targets. While this will result in increased scale and downward pressure on deployment costs for technologies such as wind, it may also create a competitive market for technologies, components and services necessary to deploy. This may limit the extent to which costs ultimately decrease for these technologies within Australia, given that a tight demand supply balance will remain.

The modelling does not include the impact of using CERs as offsets

Given that the Discussion Paper proposes that CERs be used as eligible offsets under the scheme, Hydro Tasmania strongly recommends that the Taskforce examines the impact that these will have on the modelling results.

## 7. The nature of permits, permit allocation and assistance measures

***It is proposed that the scheme would only have one form of permit – the annual permit. Each annual permit would be marked with the first year on which it became valid (its vintage).***

Hydro Tasmania supports the concept of annual permits, provided that they are distributed on the basis of a mix of administrative allocation and auctioning, and that gratis allocation is transitioned to full auctioning as soon as possible (eg within five years) to ensure full cost pass through to the energy price.

***It is proposed that permits be structured as secure property rights.***

Hydro Tasmania agrees with this approach.

***It is proposed that the allocation mechanisms should avoid rules that encourage firms to continue to emit, such as updating mechanisms or "use it or lose it" rules for generators upon closure.***

Hydro Tasmania agrees with this approach as a means to encourage earlier abatement action for least cost.

***The combination of allocations to generators, trade exposed, energy-intensive industries and auctioning is intended to avoid market power problems in the permit market.***

Hydro Tasmania submits that the intent of introducing a combination of auctioning and allocation should be to facilitate emissions abatement, not to avoid market power problems in the permit market. A scheme design that transitions the allocation of permits from gratis allocation to full auctioning within a short time period (eg five years) would achieve this objective, while simultaneously allowing the permit market to operate efficiently and eliminate any market power problems.

***It is proposed that no free allocation of permits be made to new entrant generators or those generators likely to be better off as a result of the scheme, such as renewable generators.***

Hydro Tasmania submits that there should be further exploration of how the allocation process could proactively facilitate investment in low emissions technologies, including increased deployment of renewable energy and retention of existing renewable assets, through permit allocation.

Investment in renewable and low emissions generation will require a strong carbon price signal which would ideally be achieved through a stringent emissions cap, punitive penalty and 100% auctioning. However, we acknowledge that the political reality is that compromises for implementation will be required (ie less stringent cap, penalty based on the marginal cost of abatement and gratis allocation of permits to incumbents).

Collectively these will act to dampen the pricing signal, to the detriment of renewable and low emissions generation developments which play a critical role in reducing generation emissions intensity. This is not consistent with the proposed scheme objective of reducing the emissions intensity of Australia's electricity sector (refer Hydro Tasmania's response to chapter 10). There is therefore a need to build in an explicit, transitional support mechanisms to encourage these technologies.

A possible resolution mechanism would be to introduce direct permit allocation to eligible zero/low emissions generation based on their emissions intensity relative to a benchmark. Hydro Tasmania would be pleased to work with the Taskforce to further examine this proposal.

***Comment is sought on the definition of a new generator and on the appropriate cut-off date on which a generator is to be classed as 'new'.***

On 20 November 1997, the Prime Minister announced a number of measures designed to reduce greenhouse gas emissions as part of his *Safeguarding the future: Australia's response to climate change* speech. Specifically, he stated that Australia must play its part in the global effort required to reduce greenhouse gas emissions, and announced that

> *"The Government is seeking realistic, cost effective reductions in key sectors where emissions are high or growing strongly while also fairly spreading the burden of action across our economy".*
>
> *"We are prepared to ask industry to do more than they may otherwise be prepared to do, that is, to go beyond a 'no regrets', minimal cost approach where this is sensible in order to achieve effective and meaningful outcomes."*
>
> *"Australia also believes that an international emissions trading regime would help minimise costs of reducing emissions. We would support emissions trading on the basis of a satisfactory initial allocation of emission entitlements and a practical resolution of the administrative difficulties involved."*

This announcement signalled to Australian industry that greenhouse gas emissions reductions would be required in the future. Hydro Tasmania submits that 1997 is therefore an appropriate starting point from which generators under the NETS should be classed as new.

***It is proposed that allocation mechanisms be as simple as possible, consistent with the need for them to be equitable, transparent and robust.***

***It is proposed that a key objective of permit allocation is to assist those who are likely to be most adversely affected by implementation of the scheme.***

***It is proposed that assistance to existing generators will seek to compensate them for estimated negative effects on profitability in relation to implementation of the emissions trading scheme.***

***It is proposed that a detailed estimation technique should be used to estimate the effects of the scheme on the future operating profits of different electricity generators.***

As stated in our November 2005 submission, Hydro Tasmania maintains that mitigation support should only be offered to those companies that are able to demonstrate that emissions trading would result in significant economic loss as a consequence of international exposure.

Allocation should be guided by equity and economic efficiency considerations. Allocation of permits should be determined by a review of various allocation processes used internationally with a view to encourage abatement activity and encouraging zero emissions generation such as renewable energy. We note that the permit allocation process must ensure that new greenhouse efficient entrants are not disadvantaged.

Furthermore, we submit that allocation to existing generators should be linked to emissions intensity rather than profit. Allocation based on profitability is an impractical method on which to base allocation, as it is prone to inaccuracies and exaggeration. We also query how allocation on the basis of compensation for lost profitability can be done equitably.

Emission intensity would be far more appropriate and measurable basis on which to base allocation, and is far more reflective of the intent of the scheme.

***It is proposed that a once-off allocation of permits be made before the start of the scheme, with no subsequent adjustments.***

***Permits may be allocated many years in advance (up to the lower bound of established gateways).***

Hydro Tasmania supports the concept of a once-off allocation at the start of the scheme if it encourages emissions intensive plant to close down now. However permit allocation based on compensating over a period of up to 20 years for estimated negative benefits may not encourage generators to reduce their greenhouse gas emissions during this period unless this free allocation is reduced dramatically over the initial years of the scheme.

Furthermore, if permits were allocated at the beginning for the whole period of the scheme (say 20 years) it would make it very difficult to iron out any problems if issues such as overallocation/overcompensation are found to have occurred.

When considering the length of the permit allocation period, some lessons should be learnt from the EU ETS experience. Over-allocation during the first phase of the scheme has led to a collapse in permit prices. Furthermore, while over-allocation occurred in most member states, under-allocation also took place in some countries and, more specifically, some sectors. This has put a disproportionate burden on these countries and sectors. The allocation problems resulted from inadequate data and inaccurate emission forecasts. Some of these problems are probably difficult to avoid when a new scheme is being established. However, the short duration of the first phase of the EU scheme (2005-2007) allows for learning and adjustment in the second phase. The EU experience points towards the benefits of an initial pilot-type phase and a regular review of allocations, even though this may be at the expense of long-term certainty.

***Comment is sought on whether compensation for generators should be based on individual power stations or on generating portfolios.***

Any allocation should be based on individual power stations rather than generating portfolios.

***It is proposed that the maximum period over which compensation would be calculated for generators is 20 years.***

***Comment is sought on the best way to provide long-term certainty on allocation in an environment in which firm caps are initially set for only 10 years.***

Hydro Tasmania strongly disagrees with the approach of compensating generators for up to 20 years. Free allocation over such a long period implies that generators need not take full responsibility for their emissions until 2030, which is highly inconsistent with an overarching aim of significant emissions reductions by the middle of the century. It is likely to encourage existing generators to keep emitting rather than installing low emissions or higher efficiency retrofits to existing plant. It is also unlikely to encourage a lift in the wholesale electricity price sufficient to encourage the uptake of new low emissions or renewable technologies.

Hydro Tasmania believes that for the scheme to be truly successful, it should commence with full auctioning and no free allocation. However, we acknowledge that the political reality is that compromises for implementation are required in order to ease the burden on the Australian economy. We therefore strongly recommend that compensation in the form of allocation should be reduced rapidly in the early years of the scheme to be eventually replaced by full auctioning. This would ideally occur within five years, but no later than 10 years after the scheme commencement in order to provide long term certainty for the period during which firm caps have been set.

This approach will facilitate a full pass through of the cost of carbon to the wholesale electricity price in the early years of the scheme, and place industry on a more sustainable approach to lower emissions economy. It will also provide long term certainty in an environment in which firm caps are initially set for only 10 years.

***It is proposed that electricity generators that close down should not be required to return any free allocations of permits to the governments that issued them. This is to avoid perverse incentives to continue to emit when it would not otherwise be profitable to do so.***

Hydro Tasmania supports this approach.

***It is proposed that the remainder of permits that are not allocated to generators or trade-exposed, energy intensive industries would be auctioned. Auction revenue would be divided among jurisdictions on a basis yet to be determined, but in a manner that recognises the differing impacts of the scheme. This revenue would be used to assist other groups, such as household, regions or small business.***

***Stakeholders views are sought on how this revenue could be best distributed and/or used to offset adverse impacts.***

Hydro Tasmania maintains that any net contribution received through the permit auctioning process should be deployed to supporting the development and commercialisation of new renewable and low emissions technologies industries in Australia. An example could be the establishment of a grant program to

provide support for the development and/or refurbishment of low and zero emission technologies.

We also propose that if no free permit allocation is made to existing renewable energy generators, some of the revenue raised from auctioning should be used to encourage refurbishment or replacement of ageing renewable assets that may not be viable unless the full cost of carbon is passed through to the wholesale electricity price. This will ensure that these assets are not replaced with cheaper, more emissions intensive alternatives (eg gas).

## 8. Institutional arrangements

***The preferred option is for the Commonwealth Government to pass legislation to enact the scheme, with complementary legislation passed by State and Territory Governments as required.***

***An alternative approach, if the Commonwealth chooses not to participate in the scheme, is for one State to pass template legislation which would then be legislatively adopted by the other State and Territory Governments***

Hydro Tasmania believes that the minimum requirement for the establishment of a cap and trade scheme as proposed is the participation of all National Electricity Market (NEM) States. The enactment of legislation by the Commonwealth Government to be adopted by each State and Territory would be the preferred approach.

***It is proposed that a central body be given responsibility for advising on a range of ongoing policy issues before the implementation of the scheme and during the scheme's operation. If the Commonwealth is involved in the implementation of the scheme, then an existing body (such as the Australian Energy Market Commission) could be tasked with that role.***

Hydro Tasmania supports the establishment of a governance body whose sole role is to oversee the NETS. This body should also be responsible for ensuring administration of liability and permit allocation, performance assessment and reporting.

***It is proposed that a general review of the scheme's rules, operation of institutions and functioning be finalised by 5 years after the commencement of the scheme with the objective of maintaining and enhancing scheme effectiveness and efficiency. The scope of the review would be developed so as to maintain investor confidence in the scheme.***

Hydro Tasmania advocates a commitment to periodic scheme review while ensuring the need for long term investor certainty. The risks arising from scientific and political uncertainties should be accommodated through periodic review processes and a focus on keeping the NETS as simple as practical.

***Comment is sought on possible mechanisms and processes by which stakeholders could participate in scheme administration and policy development***

Stakeholder participation in a transparent and decisive process is essential to ensuring the scheme delivers on its objectives. The establishment of an expert advisory panel could also be effective in complementing policy development processes and providing valuable guidance for scheme administration.

The National Electricity Market Rule change process provides a useful example of mechanisms for ensuring stakeholder participation in crucial decision making processes.

## 10. Accommodating multiple objectives

***Summary –***

***The design of a national emissions trading scheme (NETS) needs to accommodate a number of objectives, including:***

- ***ensuring environmental integrity***
- ***promoting investor certainty***
- ***minimising economic impact***
- ***ensuring flexibility***
- ***equity.***

In addition to these key objectives Hydro Tasmania believes that the key objective of the NETS is to transition Australia's economy towards a lower emission trajectory necessary to respond to the climate change challenge. This will reduce the financial risk for industry associated with increasing greenhouse gas constraints and avoid locking the economy into a higher emission profile possible with climate change policy uncertainty.

Hydro Tasmania also submits that in reaching this objective, a further objective of specifically reducing emissions from the electricity sector should be introduced, as this is the sector at which abatement is initially directed. The NETS should also provide strong incentive for the development of breakthrough technologies in renewable and low emission energy generation technology and a range of demand side emission abatement technologies. This can ultimately ensure that Australia develops worlds best abatement technologies and solutions and a strong export industry in the rapidly growing international market.

Consistent with this, the scheme should also aim to encourage the retention of existing zero and low emissions technology assets. As detailed in our response to Chapter 6, beyond 2030 there could be significant decommissioning of ageing hydro assets or wind projects that are reaching their end of life. If these

assets are replaced by alternate higher emission sources such as gas, Australia's emissions profile is likely to increase rather than the decrease. It is therefore important that the scheme aims to encourage the retention (through refurbishment or replacement) of these assets.

## 11. Transitioning to the NETS

***Detailed comments are sought on the proposed approaches to harmonisation with existing market mechanisms, and how the NETS should be designed and implemented to minimise disruptions and provide an appropriate level of certainty to facilitate investment in abatement projects.***

Hydro Tasmania strongly agrees with the Discussion Paper's conclusions that the MRET, VRET and other initiatives to encourage the uptake of renewable energy can operate in parallel with the NETS. These important industry development mechanisms will be particularly important if there is not full pass through of the cost of carbon to the wholesale electricity price.

## 12. Linking with international schemes

***It is proposed that bilateral linking is an option that could be explored at a subsequent stage in the scheme's development. In any event, this issue would be more appropriately dealt with by the Commonwealth Government.***

***It is proposed that unilateral linking with the CDM be achieved through recognising CERs as equivalent to offsets under the NETS.***

An Australian NETS should be consistent with appropriate principles of key international schemes (eg the EU ETS) to the extent that it would allow integration at an appropriate time in the future. Consideration should also be given to the future potential for the scheme to link bilaterally to international state-based schemes.

Hydro Tasmania supports the proposal to link with the CDM and recognise CERs as equivalent to offsets. However this should be tempered with the desire to achieve emissions reduction domestically and limit the extent to which global price fluctuations may cause instability within the NETS. A stringent cap on the number of CERs eligible within the NETS would be important in maintaining these objectives, and is further discussed in our response to Chapter 4.

## 13. Complementary measures

***Comments are sought as to:***

- ***whether there are additional complementary measures to improve the effectiveness and efficiency of the NETS that are required, and if so, of what type, and why?***

- ***whether any of the complementary measures presented in this Chapter are likely to become less important under a NETS.***

The proposed NETS will provide greater incentive for the development and deployment of renewable energy technologies. As stated previously, investment in renewable and low emissions generation will require a strong carbon price signal which would ideally be achieved through a stringent emissions cap, punitive penalty and 100% auctioning. However, in the absence of a strong carbon price signal, there will be a requirement for additional complementary measures to facilitate the uptake of new, and replacement of existing, renewable assets until such time as they becomes competitive against other technologies.

While deployment costs for renewable energy technologies are declining, further incentives remain necessary until cost convergence with incumbent fossil fuel technology is achieved in the future. Additional policy measures are necessary to achieve this and sustain the renewable energy industry. The renewable energy industry is currently considering policy mechanisms that can build on the success of the MRET incentive, including a low emissions technology target and a clean energy trust fund. These initiatives will further encourage the uptake of renewable energy and can operate in parallel with a NETS.