

TRUenergy

**Response to Inter-Jurisdictional Working Group on Emissions Trading
A National Emissions Trading Scheme, Background Paper for Stakeholder
Consultation, 12 September 2005**



TRUENERGY RESPONSE TO
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A NATIONAL EMISSIONS TRADING SCHEME, BACKGROUND PAPER FOR STAKEHOLDER
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ABOUT TRUenergy

- TRUenergy supplies gas and electricity to more than 1.1 million residential and business retail customers throughout Australia. It has a significant portfolio of industrial and commercial customers, and assets including a gas storage facility at Iona near Port Campbell (Victoria) and power stations at Yallourn (1480 MW, Victoria) and Torrens Island (1280 MW, South Australia).
- Yallourn Power Station supplies 22% of Victoria's electricity needs and 8% of the national market needs. The adjacent brown coal mine is the largest open cut coalmine in Australia with reserves to meet the projected needs of the power station to 2032. Torrens Island Power Station is the largest gas-fired power station in Australia. It supplies around 25% of South Australia's energy needs and is Australia's single largest end-user of natural gas. TRUenergy is also developing a major gas-fired power station near Wollongong in New South Wales and is a significant purchaser of wind power and other renewable energy generated electricity.
- With its portfolio spanning the full value chain in gas and electricity, together with current initiatives in further retail customer growth and infrastructure development, including low greenhouse gas emission generation, TRUenergy is in a unique position to understand the value trade offs and provide a balanced view of the emissions trading issue.

GENERAL COMMENT

- TRUenergy agrees, as noted by the Productivity Commission in its Report No 36, of 31 August 2005, that there is a mix of ways to achieve greenhouse gas abatement. These include reducing land clearing, storing carbon dioxide in geological strata, increasing the use of energy from renewable or nuclear sources, and increasing energy conservation and energy efficiency by increasing the prices of carbon fuels. An effective and efficient emission abatement policy is more likely to be achieved if thorough consideration is given to the contribution of all feasible options.
- TRUenergy supports the implementation of policies and incentive schemes that provide encouragement and support for voluntary actions including fuel switching, low emissions technology development, carbon capture and sequestration, energy efficiency and conservation.
- TRUenergy believes it is essential that a scheme is established that provides certainty to investors on the price of carbon in the medium to long term. Without this certainty, investment and sovereign risks are substantially increased on future electricity generation investments, for any fuel source.
- In TRUenergy's view the case for a decision to implement an emissions trading scheme has not yet been established. Further robust economic analysis is required, not only regarding the cost/benefit of emissions trading, but of alternate approaches to emissions reduction, and their relative impacts on states, sectors, businesses and consumers. Further design and development is required to:
 1. ensure that a scheme is established on a robust national policy level which ensures a net benefit to Australia, including overcoming constitutional and administrative issues;
 2. deliver the required reduction in actual emissions, commensurate with Australia's obligations and contributions;
 3. ensure fungibility with international policy initiatives, to allow least cost solutions;
 4. equitably allocate liability across emitting sectors, to ensure a broad, deep market framework for certificate or permit trading;

5. protecting existing rights, including (a) full grandfathering of rights to emit for existing operations, and (b) full grandfathering for investments made under existing schemes (eg. REC's, NGAC's etc.); and
 6. allow full and effective cost pass through to end users.
- TRUenergy recommends that because Australia is on track to meet its 2008-10 Kyoto emissions target, the development of further policy on emissions abatement should be focused predominantly on defining and meeting requirements beyond this period.
 - TRUenergy would be pleased to discuss the proposals in more depth and participate in any analysis to assist in the development of effective emissions abatement mechanisms.

TRUENERGY COMMENTS AGAINST SPECIFIC QUESTIONS / PROPOSITIONS

Issues for Consideration

TRUenergy comment:

- Climate change is a global phenomenon which requires a sustainable global response if greenhouse emissions are to be reduced significantly. The Australian policy response requires a wide reaching national and long-term approach.
- Any long-term approach to address climate change must engage all major emitters and recognize practical actions to develop and deploy technologies.
- TRUenergy contends that the scheme, like any regulatory proposal must undergo a rigorous review for regulatory impacts, consistent with stated government policy positions in respect of new regulations. As the Victorian Treasurer recently affirmed "the regulatory decisions made by the Government will be made on the basis that the benefits to Victorians will outweigh the costs"¹ and new regulations will not "unnecessarily impede business growth, productivity, entrepreneurship and innovation"².

Proposition 1

That a cap and trade approach be used as the basis for scheme design

TRUenergy comment:

In order to meet the criteria discussed above, any emissions trading scheme must bear the following characteristics. It must:

1. be supported by a cost benefit analysis to validate that such a scheme is the most effective and efficient to deal with the emissions reduction required;
2. protect existing investment decisions against sovereign risk and provide support for investment certainty, including:
 - full 'grandfathering' of rights to emit for existing operations, and
 - full 'grandfathering' for investments made under existing schemes;
3. allow for the full, effective and efficient cost pass through to end users;
4. be national and target all sections of the economy to ensure most cost effective national reduction; and

¹ Victoria Leads the Way with Single Guide to Regulation, Media Release from the Office of the Treasurer, 1 March 2005

² Victorian Treasurer Brumby, 1 March 2005

5. be fungible with international emissions reduction regimes in the longer term.

Proposition 2

That the scheme be national and sector based

TRUenergy comment:

- TRUenergy believes that a nationally consistent approach is essential to be effective and to minimise business and government costs associated with scheme design and administration.
- TRUenergy supports a national climate change policy which provides:
 1. a robust and stable national regulatory framework;
 2. a focus (but not necessarily an exclusive focus) on technological development to reduce the cost of emissions abatement;
 3. that, if there is to be a carbon price signal, it be determined by a market based mechanism (ie. not a tax);
 4. for an orderly transition from disparate short-term mandatory schemes without compromising long-term investments made in such schemes (i.e. consistency with grandfathering principle); and
 5. for low administration costs.
- If a cap on emissions is required then TRUenergy supports a sector-based approach – with targets allocated to emitting sectors generally in proportion to their level of emissions rather than the cap being determined or differentiated on a State or Territory basis - to ensure that the scheme is effective and efficient.
- TRUenergy's view is that more work is necessary to secure a national approach to policy.

Proposition 3

That in setting the cap, consideration be given to the overall national emissions abatement target, and how the abatement responsibility is allocated between sectors covered by the scheme and those outside the scheme

TRUenergy comment:

- TRUenergy supports emissions targets being determined on a national basis and being consistent with the achievement of an overall national target determined for Australia.
- Targets should be allocated to emitting sectors generally in proportion to their level of emissions – requiring all emitting sectors to be liable for their share of emissions reductions.
- As Australia is on track to meet its 2008-10 Kyoto emissions target, the development of further policy on emissions abatement should be focused predominantly on defining and meeting requirements beyond this period. The intervening period should be used to design scheme requirements outlined above, including inclusion of non-stationary energy sectors and transitional arrangements.
- Targets should be set in a manner that provides a net benefit to Australia. As noted under Proposition 1 above, any emissions trading scheme must:
 1. be supported by a cost-benefit analysis to validate that such a scheme is the most effective and efficient to deal with the emissions reduction required;
 2. protect existing investments and provide investment certainty, by:
 - 'grandfathering' rights to emit for existing operations; and

- 'grandfathering' investments made under existing schemes;
 - 3. allow for the full, effective and efficient cost pass through to end users;
 - 4. be national and target all sections of the economy to ensure most cost effective national reduction; and
 - 5. be fungible with international emissions reduction regimes.
- TRUenergy notes the recent *Cost to Consumers of Greenhouse Emissions Abatement Schemes* study by the Energy Retailers Association of Australia³ that shows, for existing mandated emissions reduction schemes (which also have an industry subsidy objective), the following range of marginal costs for carbon abatement in 2010:
 1. The MRET scheme between about \$60/tonne CO2 and \$73/tonne
 2. The NGAC scheme between about \$38/tonne and \$51/tonne
 3. The GEC scheme between about \$50/tonne and 68/tonne.

Proposition 4
That the scheme initially cover the stationary energy sector

TRUenergy comment:

- TRUenergy believes the scheme should extend to sectors other than the stationary energy sector to ensure broad coverage and allow for a mix of the more cost-effective abatement options.
- TRUenergy notes with concern the suggestion in the Background Paper that the Working Group appears undecided about expansion to other sectors. There should be no doubt, and the timing should be clear and early.
- Assigning liability to emitting generators is supported, provided that protection is assured for existing investment decisions against sovereign risk, by:
 - a. 'grandfathering' rights to emit for existing fossil fuel generators, and
 - b. 'grandfathering' investments made under existing schemes (eg. REC's, NGAC's etc.).
- TRUenergy believes existing reporting and assessment regimes should be utilized wherever possible to avoid the imposition of further regulatory administrative costs.

Proposition 5
That the scheme cover all six greenhouse gases under the Kyoto Protocol

TRUenergy comment:

- TRUenergy supports a goal of including the six Kyoto greenhouse gases. If it is difficult to cover all six gases immediately then a staged implementation plan including dates, must be developed.
- TRUenergy Yallourn reports emissions data as part of the National Greenhouse Gas Inventory, Greenhouse Challenge Plus and Generation Efficiency Standards programs and reports to Victoria's EPA on greenhouse and energy efficiency plans. Reporting requirements should be streamlined to minimise the administrative burden on business.

³ A Report on the Cost to Consumers of Greenhouse Emissions Abatement Schemes, 2005

- A transition period is appropriate for industry to establish a new reporting regime and prepare for reporting emissions that may be required in addition to current reporting arrangements.

Proposition 6

That permit allocation be made on the basis of a mix of administratively allocated and auctioned permits, with both long and short term (annual) permits

TRUenergy comment:

- Any emissions trading scheme must provide protection for existing investment decisions against sovereign risk and support for investment certainty. The value of existing fossil fuel generation assets must be protected and permit allocation at current emissions levels for the economic life of the asset to achieve this.
- TRUenergy supports the issue of 'one-off' administratively allocated permits at no cost as a property right to incumbent generators with long-term (ie. economic life) validity and free fungibility in any national and international emissions reduction/trading scheme.
- TRUenergy does not support auctioning permits, as the up-front costs are likely to be excessive and potentially disruptive to the reliability and security of electricity supply.
- If auctions are held, however, then the funds raised should compensate those adversely impacted by the introduction of the scheme and then returned to industry and to the companies with the most cost effective emissions reduction projects (provided those projects meet some threshold criteria including per tonne cost in line with a government assessment of the overall value of the national emissions reduction program and target). This return should be in addition to other forms of value the project may provide to its stakeholders, including power generators, as compensation for those who can show hardship and as a positive incentive for implementation of abatement.
- Allocation and acquittal mechanisms need to be closely linked to the activities that can be influenced by changing behaviours, particularly new investment activities. TRUenergy does not favour compensation to regions or export/import industries by additional permit allocation, as this will restrict the pool of available permits to liable parties and introduce inequity issues that will be difficult to resolve. If compensation is considered necessary, alternative compensation policies will need to be adopted.
- The characteristics which must be exhibited by any emissions trading scheme are set out in our response to Proposition 1.
- If a thorough cost-benefit analysis indicates a cap and trade scheme is the most cost effective way to address greenhouse gas emissions, we comment as follows:
 1. The overarching criterion for selecting the method of allocation should be to minimise sovereign risk.
 2. For investments made in good faith prior to the introduction of any scheme, permits should be allocated for the lives of the assets affected. This approach would:
 - a. support the investment environment by minimizing sovereign risk;
 - b. minimize sudden economic shocks, by focusing the cost of carbon onto future investment decisions; and
 - c. be consistent with a long-term approach to reducing carbon intensity in the economy.
 3. Inappropriate allocation approaches run the risk of substantially reducing shareholder value, undermining the rights to operate granted to them through issue of coal generation licences and derogating from the value of the generation assets. Any such outcome could have substantial negative investment outcomes that could be counterproductive to

attracting the investment capital that will be required to develop new less carbon intensive assets in the future.

4. Full grandfathering of emission permits would remove this risk and provide an incentive on incumbents to minimize their emissions (by exposing them to the opportunity cost of consuming a credit rather than selling it into the trading scheme).

Proposition 7

That a penalty should be set to encourage compliance and to establish a price ceiling for the permit market

TRUenergy comment:

- TRUenergy suggests that as assessment of penalty levels is closely linked to the achievement of specified target levels, further analysis work is required to understand the impacts and assess whether the benefits outweigh the costs.
- If there is a penalty on a per tonne basis, it should have a price ceiling, which should reflect what the nation considers the value of the emissions reduction.
- Penalties should not be internationally linked – where the international price reflects the tightness of supply and demand in those markets and not the marginal cost of abatement, or the benefits of avoided emissions elsewhere in the world. For example, Australia should not be adversely affected if the EU market price skyrockets due to supply and demand imbalance.

Proposition 8

That offsets be allowed

TRUenergy comment:

- TRUenergy supports the proposal to allow offsets, as this will help achieve economy wide emissions reduction at lowest cost to the community.
- A transition period should be allowed for in improving penalties to allow offset assessment, measurement and compliance issues to be 'bedded' in.
- No feasible or viable offsets should be excluded.

Proposition 9

That mechanisms be included to address adverse effects and structural adjustment

TRUenergy comment:

- TRUenergy supports this proposition.
- Investors in lignite-fueled processes should be considered where there is structural disadvantage with respect to others.

Proposition 10**That mechanisms be included to allow a transition for participants who have taken early abatement action and new entrants****TRUenergy comment:**

- TRUenergy supports a mechanism that rewards companies with credit for early action under government-organised climate program, where documentation establishing such reductions exist.

PROPOSED NEXT STEPS**TRUenergy comment:**

- More thorough analysis is required to confirm the need and timing for an emissions reduction scheme and to confirm the net environmental and economic benefits will be delivered for Australia over the longer term and the related cost impacts to consumers, compared with other approaches such as voluntary reductions under incentive programs and investment in technology innovation, as well as the other design and development issues identified in our general comments above.
- Regular consultation on this analysis with key stakeholders is desirable through 'roundtable' discussions.

OTHER SCHEMES**TRUenergy comment:**

- Subject to support for 'grandfathering' rights for investments made under existing renewable energy and low emission mandated schemes, a national scheme should replace the existing various state based schemes. There is ample evidence to conclude that the existing schemes are inadequate as long-term initiatives, as they have been of limited effectiveness in emissions reduction and are not cost effective.
- The proposed scheme should be national, long-term, emissions reduction focused and should, with appropriate transitional arrangements, replace the disparate existing emissions reduction schemes.