25 September 2012

Senator Mark Bishop
Chair
Senate Economics Legislation Committee
Parliament House
Canberra
economics.sen@aph.gov.au

AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

Dear Senator Bishop

SENATE STANDING COMMITTEE ON ECONOMICS – CLEAN ENERGY AMENDMENT BILLS 2012

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to comment on the Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012 (the Bill) and related bills.

AIGN is a network of Australian industry associations and businesses that have a serious interest in climate change issues and policies. Its members account for over 90% of Australia's mining, manufacturing and energy transformation emissions.

Attached is a copy of AIGN's response of 6 September 2012 to the Department of Climate Change and Energy Efficiency providing comment on the drafts of the Clean Energy Legislation Amendment Bill 2012. Given the timing for this Inquiry we have not been in a position to update this document.

AIGN's members have a range of views on greenhouse and energy policy. This letter and the attachment represents the views of AIGN members in general, though it may differ in some particulars from the positions of some individual member associations and companies. Some members have prepared submissions of their own, and this AIGN submission should be read in conjunction with those submissions.

AIGN supports a national climate change policy that delivers abatement at least cost and facilitates investment decisions consistent with an effective international price on carbon. The pricing mechanism design must provide businesses with the confidence needed to undertake long-term investments in low emissions technology and infrastructure.

In the attached submission we welcome a number of the proposed amendments, particularly the removal of the floor price. However the ability to comment in detail on the original significant policy changes was limited by the lack of previous consultation and limited explanatory notes, as well as limited time for appropriate and comprehensive analysis of the issues

AIGN's primary concerns with the draft Amendments relate to a number of key issues:

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- uncertainties around potential processes for putting limits on the importation of international permits which had the potential to cause increased industry uncertainty;
- changes to the natural gas liability arrangements were considered unworkable as while seemingly focussed on a narrow set of arrangements that may apply in a specific set of yet to be determined circumstances, raise a series of potential commercial distortions, complications and administrative burdens that extend to the entire natural gas liability provisions currently contained in the Clean Energy Act 2011;
- the lack of parameters around the flexibility to make further changes to the scheme. While a large amount of flexibility may be appropriate in some circumstances, liable entities and other market participants require a more structured framework around regulatory powers to facilitate investment decision-making; and
- Difficulties in commenting on the legislative package when considered analysis of the implications can only be undertaken when the regulations are made available.

AIGN is conscious that the legislation has entered into Parliament (and subject for consideration by this Committee) and a number of issues raised by AIGN have been addressed as well as the repeal of the Clean Energy (International Unit Surrender Charge) Act 2011 as supported.

The Network welcomes the limitations upon the Minister to impose further sub-limits on Kyoto units to 2020 (as against with as little as a year's notice). This increases the confidence in the arrangements and reduces the risk for those participants that will be looking to purchase international permits to meet compliance

In regard to the Amendments relating to natural gas we note that the Government has provided a number of options for consultation to obtain input on the detailed arrangements that will be set out in subsequent regulations.

Notwithstanding these improvements in the scope for consultation and feedback the AIGN remains particularly concerned with the complexity of the proposed amendments to the legislation impacting on natural gas supply and liability. The ongoing limited opportunity for affected businesses to review these proposed changes means that it has not been possible to fully analyse the amendments nor consider implications for existing and future commercial arrangements, administrative costs and reporting obligations.

Given that we expect the first compliance year of the carbon pricing mechanism will uncover and highlight many issues with the current legislation, we strongly recommend that these sections of the amendments be removed now and industry consultations be formally initiated to determine the best course of action. If indeed there are material gaps to coverage in the natural gas supply chain, these will be clearer after 1 July 2013. If there is a gas market participant that is not effectively covered

under the exiting legislation, then we suggest a more targeted approach to resolving this issue rather than that proposed in the current amendments.

The current amendments, and the yet to be released regulations, create considerable uncertainty and disquiet for all gas market participants. The gas supply chain is complex and varies on a geographic basis and with the deepening spot market, new issues are now being identified. This market warrants a comprehensive review of existing legislation in order to fully appreciate any gaps and resolve a way forward. AIGN does not support the approach taken in the Bill and we recommend further industry consultation on these matters.

AIGN would also re-iterate that while the European Union Emissions Trading Scheme (EU ETS) is currently the largest ETS in the world, many of Australia's trade competitors are outside of the EU. Concerns with respect to international competitiveness have not reduced as a result of the decision to legislate and operationalise a unilateral link with the EU ETS. In the transition period to a broader international trading system with potentially all major economies, competitiveness must be preserved.

Australian industry has concerns as to how will Australian competitiveness be 'preserved' if the EU continues to use policy drivers to change their scheme. The EU will do that in their interest which will not necessarily be in ours. It will simply drive up our costs and should be addressed in both the bilateral agreement and the regulation.

Yours sincerely

Alex Gosman
Chief Executive Officer

6th September 2012

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AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

Attention:
Mr James White
Assistant Secretary
Strategy & Market Linkages Branch

Mr Simon Writer
Assistant Secretary
Design, Coverage & Regulatory Branch

Dear James and Simon,

Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012

Introduction

The Australian Industry Greenhouse Network (**AIGN**) welcomes the opportunity to comment on the draft of the *Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012* (**the Bill**) and the related bills. AIGN is a network of Australian industry associations and businesses that have a serious interest in climate change issues and policies. Its members account for over 90% of Australia's mining, manufacturing and energy transformation emissions.

AIGN's members have a range of views on greenhouse and energy policy. This submission accords with the views of AIGN members in general, though it may differ in some particulars from the positions of some individual member associations and companies. Some members have prepared submissions of their own, and this AIGN submission should be read in conjunction with those submissions.

In this submission AIGN makes a number of general comments relating to its position on climate change policy and the need for adequate time for consultation. The submission then addresses a number of specific points raised by the draft legislation.

AIGN's Position On Climate Change Policy

AIGN supports a national climate change policy that delivers abatement at least cost and facilitates investment decisions consistent with an effective international price on carbon. The challenge is how to navigate the transitional issues associated with the movement towards an international carbon price.

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The pricing mechanism design must provide businesses with the confidence needed to undertake long-term investments in low emissions technology and infrastructure. Without this certainty, the necessary mobilisation of private capital will not take place in a way that delivers a least-cost outcome for businesses and the economy. Major investment in low emissions technology requires an institutional framework that is stable, transparent, and allows businesses to manage uncertainty over 15 to 20 year 'bankable' periods in line with capital investment cycles. For AIGN, it is critical that the carbon pricing mechanism effectively deals with the issues of trade-exposed industries and the electricity sector to drive investment confidence in the those industries, where much of the new investment pipeline is focussed.

General Comments

Whilst appreciating the pressures upon the Department in preparing the draft legislation, substantial policy changes with limited consultation causes significant uncertainty within industry. Given the limited time to comment on the draft legislative package, we have by necessity focussed on specific issues. Many of the proposed changes are very significant for AIGN members and the implications need to be considered from different business perspectives.

We also note that some of aspects of the drafting of the Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012 are, for the business reader, complicated and convoluted and raise significant and complicated liability, commercial and contractual issues. The lack of previous consultation and limited explanatory notes has not provided sufficient time for appropriate and comprehensive analysis of the issues and limited the opportunity for some businesses to respond in the restricted timeframe requested by the Department.

We therefore offer our initial comments on the draft bills and will be in contact with the Department again should further issues be identified. We also suggest that a follow-up workshop be held with key stakeholders after comments are received to discuss the final version of the amendment package.

A concern for AIGN is the lack of parameters around the flexibility to make further changes to the scheme. While a large amount of flexibility may be appropriate in some circumstances, liable entities and other market participants require a more structured framework around regulatory powers to facilitate investment decision-making.

Further, it is very challenging to comment on the legislative package when considered analysis of the implications can only be undertaken when the regulations are made available. We do not yet have that detail, so AIGN can only comment effectively on a best guess of what will be included in the regulations. This is a flawed approach and AIGN suggests that further changes either be embedded in the Acts or that the proposed regulations be released at the same time as the proposed amendments to the Acts.

International linking

AIGN supports Australia making an equitable contribution to global action to reduce greenhouse gas (GHG) emissions to mitigate the impacts of climate change. AIGN members envisage a global agreement that imposes on the Australian community costs that are

comparable to the costs expected to be borne in similarly developed countries and other major economies.

While we fully expect differentiated national approaches, over the longer term it is acknowledged that there are potential benefits in developing a workable global emissions trading system that is environmentally effective, economically efficient and equitable. However, given the current state of international negotiations, it is not likely that such an outcome will be achieved in the short-medium term.

It is much more likely that a bottom-up process with links between national emissions trading schemes (ETSs) slowly evolves into a bigger network to enable trading of carbon units across borders. The political, economic and trade challenges are significant and flexibility will be essential for each participating country in terms of emission targets, competitiveness mechanisms and approaches to offsets.

The Australian and European Union Governments have initiated movement towards international linkages. The details are critical. The draft *Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012* provides some information on the arrangements for the first phase – unilateral linking. However this draft legislation raises many questions on the operation of this one-way linkage but does not resolve some key issues for Australian liable entities, investors and market participants. One of the major issues for AIGN members in reviewing and commenting on this draft legislation is that the Australian Government has determined that many critical factors are not specified in the draft legislation but will be included in the regulations. This approach creates a high level of uncertainty for Australian business.

While the European Union Emissions Trading Scheme (EU ETS) is currently the largest ETS in the world, many of Australia's trade competitors are outside of the EU. Concerns with respect to international competitiveness have not reduced as a result of the decision to legislate and operationalise a unilateral link with the EU ETS. In the transition period to a broader international trading system with potentially all major economies, competitiveness must be preserved.

It is also an expectation that for Australia to enter into any international linking agreement, one of the benefits will be access to least cost abatement and an opportunity for Australian liable entities to reduce their cost of compliance.

AIGN's review of the amendments in the Bill and our assessment of the linking arrangements with the EU ETS is keenly focussed on achieving both of these objectives – preserving international competitiveness and reducing compliance costs. Our initial response is that this Bill does not guarantee either of these desired outcomes for all industries.

There are some obvious differences between the Australian carbon pricing scheme and the EU ETS. As negotiations continue to create a 2-way link between the schemes, many design aspects will come under scrutiny as options for achieving compatibility are explored. These processes create considerable regulatory uncertainty for liable entities in both schemes. Critical design issues for liable entities include permit allocation, coverage and use of offsets. Australian liable entities require appropriate lead times for any design changes. AIGN suggests that the government seek to undertake comprehensive stakeholder engagement if design changes are proposed in the future.

Natural gas

AIGN is particularly concerned with the complexity of the proposed amendments to the legislation impacting on natural gas supply and liability. The limited opportunity for affected businesses to review these proposed changes means that it has not been possible to fully analyse the amendments nor consider implications for existing and future commercial arrangements, administrative costs and reporting obligations.

Given that we expect the first compliance year of the carbon pricing mechanism will uncover and highlight many issues with the current legislation, we strongly recommend that these sections of the amendments be removed now and industry consultations be formally initiated to determine the best course of action. If indeed there are material gaps to coverage in the natural gas supply chain, these will be clearer after 1 July 2013. If there is a gas market participant that is not effectively covered under the exiting legislation, then we suggest a more targeted approach to resolving this issue rather than that proposed in the current amendments.

The current amendments, and the yet to be released regulations, create considerable uncertainty and disquiet for all gas market participants. These amendments are cumbersome, overly complicated and in some cases, appear to create duplication. The gas supply chain is complex and varies on a geographic basis and with the deepening spot market, new issues are now being identified. This market warrants a comprehensive review of existing legislation in order to fully appreciate any gaps and resolve a way forward. AIGN does not support the approach taken in the Bill and we recommend further industry consultation on these matters.

Removal of floor price

The proposal, under Part 3 of the Bill, to repeal the entire Clean Energy (International Unit Surrender Charge) Act 2011, is consistent with AIGN's position in previous submissions. The floor price – designed to apply for the first 3 years of the flexible pricing period – created market distortions and increased costs for market participants and end users. It would have been administratively complex – almost unworkable – and created investment uncertainty. Liable entities have been wary of entering the carbon market until this issue was resolved. For these reasons, AIGN supports the removal of the floor price and repeal of the relevant Act.

Specific comments

Clean Energy Amendment (International Emissions Trading and Other Measures) Bill 2012

Schedule 1 – Amendments

Part 1 – General Amendments

Australian National Registry of emissions Units Act 2011

S48 When Australian-issued international units may be issued

A number of specific drafting concerns have been identified in relation to the new section 48D(2)(a). For example, the requirement that the transferor 'owns' the units may create difficulties in practice. It is unclear why "ownership" should be a test in this context. The

question may arise of how would the transferor be required to demonstrate ownership, especially given the different legal systems within which units are issued?

In relation to new section 48D in practice, it is unclear how will the Regulator keep track of which European units have been transferred into its account by the person making the application? For market participants, there needs to be an efficient system that minimises operational cost and risk.

With regard to new section 48D and clause 23, new section 66C we seek further clarification as to how these two clauses fit together? Section 48D allows the transferor to nominate another person to whom the units will be issued; but clause 66C would only seem to apply if the nominee is also the person who committed the fraud.

S59A Information about Australian–issued international units

AIGN does not support the disclosure of information relating to the persons to whom the units are issued as this information is commercially sensitive.

66A Cancellation of Australian-issued international units

New section 66A is another wide and uncertain regulation which could affect the value of these units, particularly if the units can be cancelled even after they have passed to an arm's length purchaser for value. In the case of cancellation, the rules should be in the Act and not in the regulations.

S66E Transfer of certain units instead of relinquishment of Australian-issued international units

(9) – AIGN does not support the unnecessary flexibility provided to the government with the respect to the arrangement whereby the regulations can specify that a unit is not a substitute unit for the purposes of this section. This is far too open and may cause undue commercial hardship.

Clean Energy Act 2011

Natural Gas provisions:

s5A

s20 (14) – (15)

s21 (8E) – (8F)

s22 (12) – (13)

s23 (9E) – 9(F)

s24 (8E) – (8F)

s25 (7E) – (7F)

s35A; s35B

s64A – 64D

The changes to the natural gas liability arrangements, while seemingly focussed on a narrow set of arrangements that may apply in a specific set of circumstances, raise a series of potential commercial distortions, complications and administrative burdens that extend to

the entire natural gas liability provisions currently contained in the *Clean Energy Act 2011*. The proposed amendments introduce new concepts ie the own-use provisions that appear to run counter to the operation of the existing provisions and appear targeted at a problem that has been notionally identified before the first compliance period under the Act has even been completed. In addition, it is unclear that the proposals in these would be workable in practice and if they are, it is most likely to lead to unacceptable additional administrative, reporting and commercial costs to liable entities.

The proposed amendments introduce, in certain circumstances, an additional 'layer' of liability that could potentially sit with the natural gas supplier. This appears inconsistent with the original intent of the Clean Energy Act 2011 and the way in which liability is determined under the relevant provisions in the existing Act.

The amendments also propose another definition of "supply" to add to the existing 'clarifications' in section 5 and section 6. By leaving the details of this new definition to yet to be drafted regulations, the provisions raise significant and inappropriate levels of uncertainty for liable entities. Suppliers would have the compliance and administrative burden of having to form a view about whether or not customers will otherwise have liability for the emissions under other relevant provisions of the Act.

The administrative challenges in meeting the requirements under these provisions would be very onerous and are unacceptable. How do suppliers reasonably assess if counterparties are not already covered by the Act? How do they know how much gas the customer is withdrawing from of the pipeline (as opposed to how much the supplier injected)? Do customers have to prove that they have title to the natural gas in the pipeline or is it the transporter/shipper? Do suppliers ask both of them for evidence? The supply of natural gas can change daily and even half hourly, making it unlikely that data will be readily available, resulting in onerous reporting and reconciliation procedures to identify liability.

Under the arrangements as currently proposed by the Bill, it would be extremely difficult for the natural gas supplier to reconcile or determine with confidence the accuracy of the liability it would potentially be incurring. It is possible for a natural gas supplier to have little or no knowledge of the facilities a self-contracting gas user is supplying, the gas they use, or if they have on-selling arrangements. This would create significant complications in providing reasonable assurance for auditing purposes with respect to liability that arrives from the proposed own-use notifications.

The amendments raise the potential for market distortions and disruption to existing commercial arrangements, for example, the proposed own use provisions could apply to gas combustion emissions for upstream facilities that are currently below threshold. If this occurred, upstream natural gas facilities would be treated differently to other upstream facilities, raising competitive neutrality concerns.

Aspects of the 'double counting' provisions appear redundant – it is a condition to the own-use provisions proposed under section 35B(1)(d) that "… it may reasonably be expected that no provisional emissions number under section 20, 21, 22, 23, 24 or 25 will be wholly or partly attributable to covered emissions from the use of the natural gas …". If that is the case, then by definition there should not be double counting.

Subsection 101 (1) Auction volumes

The draft legislation increases the upper limit on auction volume in 2013-2014 from 15 million to 40 million. AIGN agrees that larger early auction volumes is likely to increase market liquidity by allowing large liable entities more ability to hedge their compliance obligations in the lead up to the flexible price period. It is not clear however, as to the rationale for the new maximum volume of units in this proposed amendment (40 million, increased from 15 million). AIGN seeks clarification from the DCCEE as to how it reached this position on the auction volumes.

S123A Designated limit

International linking leads to price discovery, which can help to reduce program costs by broadening the scope of available mitigation opportunities while further sparking competition to innovate and mitigate greenhouse gas emissions. The Bill proposes to introduce the concept of a "designated limit", to limit availability of specified eligible international emissions units (initially Kyoto units). The Bill specifies a limit of 12.5% in the absence of regulations stating otherwise, so this limit is subject to potential future amendment. It is difficult to understand the reason why there needs to be a regulation to allow for adjustment of the 12.5% limit between now and 2015. This power creates unnecessary uncertainty for market participants.

As set out in the Explanatory Memorandum, this proposal aims to ensure the convergence of Australian and EU carbon price. However it also introduces additional cost and uncertainty for liable entities and is inconsistent with the policy goal of reducing greenhouse gas emissions at least cost. Australian industry also has concerns as to how will Australian competitiveness be 'preserved' if the EU continues to use policy drivers to change their scheme. The EU will do what is in their own interests - which will not necessarily be compatible with Australian circumstances. It has the potential to drive domestic costs and this concern should be addressed in both the bilateral agreement and the regulations.

In terms of the draft legislation, AIGN has concerns with the drafting on this section, particularly the wide powers available to the Minister to impose further sub-limits with as little as a year's notice. This removes the necessary confidence in the arrangements and increases the risk for those participants that will be looking to purchase international permits to meet compliance. We would argue that the legislation should include be some form of safeguard or grandfathering provisions for international permits that have been purchased in good faith.

Although in section 123A(4), a notice period of two years is proposed for placing further limits on the import of international permits, under proposed section 123A(5), this notice period can be shortened to one year if the Minister is satisfied that the change is necessary, for example, to meet an international agreement. These notice periods are inadequate and will discourage investment in international permits and further raises costs for liable entities.

Although Minister Combet is on the public record stating that under the planned amendments to the *Clean Energy Act 2011*, liable entities will be able to use Kyoto credits for up to 12.5% of their compliance level, the Bill, and as yet unseen regulations, allows for changes to this limit for essentially any reason. A spokesperson for Minister Combet was recently quoted as saying that such changes with only 1 year's notice would made on the

basis that the changes would be anticipated to be beneficial in nature. AIGN understands that government seeks to have this flexibility in order to respond to changed international circumstances and to facilitate future linking with other ETSs. However, it is not clear how the government would assess the beneficial nature of such changes to Australian liable entities and other market participants, given the wide range of possible impacts. The lack of consultation on these amendments does not give industry confidence that it would have any input into determining what is "beneficial".

AIGN strongly advocates a compromise position be sought. Given the nature of international negotiations and the issues at stake, it is certainly not unreasonable to legislate a minimum of 3 years notice for changes to apply to design features such as the limits to be placed on specific classes of carbon units. Any period less than 3 years creates unacceptable risk for Australian business and the national economy.

Additional comments

- With the inclusion of European Union Allowances (EUAs) into the Australian system, we understand that EUAs will now be considered as Financial Products under Australian legislation, and thus be covered by the Australian Financial Services Licensing (AFSL) provisions. This being the case, what are the implications for licensing requirements for advisors, dealers, and brokers?
- AIGN encourages a direct link between the Australian and EU registries as soon as possible. We are willing to work directly with the Department to achieve a speedy resolution that will facilitate low transaction costs for our members.

Conclusion

AIGN is cognisant of the government's intent to introduce this legislative package during the Spring session of Parliament - however we recommend an intensive and expedited consultation program be initiated to improve the drafting of the amendments.

In particular any legislative amendments to the natural gas provisions of the Clean Energy Act 2011 should be delayed until the first compliance year of the carbon pricing mechanism has been completed. The proposed comprehensive stakeholder engagement process should agree on any gaps in coverage across the natural gas supply chain, quantify any identified gaps, and test options to remedy the situation if justified with a targeted approach to the specific issues.

Yours sincerely

Alex Gosman
Chief Executive Officer