

Senate Standing Committee on Economics  
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31 March 2016

Dear Secretariat,

### **AGL Energy Response to consultation on carbon risk disclosure**

AGL Energy (**AGL**) welcomes the opportunity to provide comment on carbon risk disclosure. AGL's Carbon Disclosure Project score in 2015 was 97<sup>1</sup> and AGL's approach to sustainability reporting is well regarded by reporting bodies<sup>2</sup>.

As a leading integrated energy retailer, AGL is well placed to provide comment on the issues and topics presented. AGL operates across the supply chain and has investments in coal-fired, gas-fired, renewable and embedded electricity generation, upstream gas production and provides energy solutions to over 3 million customers. The diversity of this portfolio has allowed AGL to develop a detailed understanding of the risks and opportunities presented by energy and climate policy. AGL economists have published a range of peer reviewed research on impacts associated with energy and climate policy.

The electricity generation sector represents approximately one third of Australia's greenhouse gas emissions profile. As such, organisations such as AGL have been voluntarily reporting greenhouse gas emission data and related information for more than a decade.

#### *Overarching approach to ESG disclosure*

The ASX Corporate Governance Council's Corporate Governance Principles and Recommendations require listed companies to disclose any material exposure to ESG related issues (and, if so, how they manage these issues), or provide reasons for not reporting such information. AGL also utilises the Global Reporting Initiative's 'G4 Sustainability Reporting Guidelines' as a useful framework for identifying and implementing the most appropriate reporting framework for an organisation. In terms of what information should be disclosed, a 'materiality review' involving quantitative surveys and interviews with key internal and external stakeholders is a useful starting point for identifying the issues that are most likely to be raised by the community, investors or other stakeholders for any particular business. For example, a materiality review of a financial institution is likely to establish low concern about direct or 'Scope 1' greenhouse gas emissions<sup>3</sup>, but possibly high stakeholder interest around the emission profile of

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<sup>1</sup> <http://aglblog.com.au/2015/11/cdp-climate-change-performance/>

<sup>2</sup> <http://aglblog.com.au/2015/06/agl-wins-ara-awards/>

<sup>3</sup> Greenhouse gas (GHG) emission types can be explained as follows: Scope 1 – all direct GHG emissions; Scope 2 – Indirect GHG emissions from consumption of purchased electricity, heat or steam; and Scope 3 – other indirect emissions, such as the extraction and production of purchased materials and fuels, transport-related activities in vehicles not owned or controlled by the reporting entity, electricity-related activities (e.g. transportation)





its loan book. The 2014 AGL Sustainability Report outlines how we at AGL approached our 'materiality review' in 2014.

Companies must be prepared to engage continuously with all their stakeholders. This is important to ensure that stakeholders have a good understanding of the company's operations and can provide input into company decision making for the benefit of the company and the broader community. AGL has a detailed stakeholder engagement matrix which aligns to material issues (which in turn have been derived from the 'materiality review'). Given the essential service nature of the supply of electricity and gas and the environmental footprint of electricity and gas production, a formal Customer Council and a Climate Change Council have been instituted, in addition to a range of other stakeholder engagement processes.<sup>4</sup> Increasingly, companies must also be prepared to respond in real-time to stakeholder questions. With this in mind, AGL has been successfully operating a Sustainability blog for several years, and is active in social media (see [www.aglblog.com.au](http://www.aglblog.com.au)).

#### *Disclosure of emissions data*

For several years, Australian companies with material greenhouse gas emissions have been reporting their emissions under the *National Greenhouse and Energy Reporting Act (NGER)*. The NGER Act requires companies such as AGL to report on emissions from facilities where the business has operational control. This information is useful for understanding climate change related risks and opportunities but it is only one measure of emissions. Alternatives to reporting emissions on an operational control basis include: financial control, equity control and supply. All four of these methodologies are suggested by the Carbon Disclosure Project and leading companies have often applied a combination of these approaches in annual sustainability reporting documentation.

The approach used in AGL's sustainability reporting provides a useful starting point. Three boundaries are defined to provide stakeholders with information about the different components of AGL's emissions inventory:

- Operational - The operational footprint covers the emissions from activities and assets that a company operates.
- Equity - The equity footprint sets out a company's share (by percentage investment level) of the emissions from fully or partially owned entities. The equity footprint indicates to shareholders and other investors the greenhouse gas emissions associated with their investment.
- Supply - The supply footprint estimates the GHG emissions associated with the consumption of the company's product by its customers. The supply footprint covers GHG emissions resulting from the production, transportation, distribution and consumption of the product through the supply chain.

By disclosing these emissions, interested parties are better placed to analyse the financial impacts associated with the introduction of an emissions trading scheme

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<sup>4</sup> <http://agl2014.sustainability-report.com.au/how-we-operate/stakeholder-engagement>



or carbon tax (or other types of climate change mitigation policies). This disclosure overcomes the shortcomings identified with the mandatory Scope 1 and Scope 2 approach by providing additional voluntary information in relation to all supply chain emissions (where estimates are possible) and equity investment emissions.

#### *Limitations of simplistic financial analysis*

There is no shortage of information on individual company emissions available to stakeholders. However, it is the application of this information to financial metrics that has resulted in significant confusion and, in some cases, misleading conclusions. Analysis of climate change risk is often presented in ways which allow for easy, but meaningless, comparisons between companies and sectors. For example, some metrics that have been used include: revenues from fossil fuels, embedded emissions in fossil fuel reserves, emissions per unit of EBITDA, and emissions per unit of market capitalisation. None of these metrics are useful for assessing the broader way in which carbon risk may manifest within industries and companies.

To provide a framework for more relevant analysis, AGL economists and environmental scientists published a 'checklist' for assessing carbon risk several years ago in the academic journal, *Sustainability Accounting, Management and Policy*.<sup>5</sup> The checklist is briefly listed here and even a cursory review of the list highlights the difficulty in assessing company risks associated with climate change mitigation policies:

- What is the carbon price (either implied or explicit)? The implied financial penalty for producing emissions (or reward for the absence of emissions) depends upon assumptions made regarding Australia's carbon budget, yearly emission reduction targets, and the policy suite implemented to reduce emissions domestically<sup>6</sup>.
- What are the businesses' Scope 1, Scope 2, supply footprint and equity emissions? Scope 1 and Scope 2 emissions will provide an estimate of the business' direct liability (taxation or permit acquisition costs) and indirect liability (energy price increases) while equity emissions provides an assessment of the potential liability associated with equity investments. Supply footprint emissions allow efficiency comparisons of businesses within an industry (i.e. comparisons of the emission intensity of products and/or services).
- What is the assumed rate of 'carbon pass through' for energy products?<sup>7</sup> An assessment of this variable will allow assumptions to be made in relation to the proportion of higher costs incurred by energy producers that will be passed through in energy procurement costs.
- Are there technologies available which would reduce Scope 1 emissions? If new lower emitting technologies are available, the rate of pass through is likely to be significantly lower. In turn, this issue when considered in the

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<sup>5</sup> Nelson, T. Wood, E. Hunt, J. and Thurbon, C. (2011), 'Improving Australian greenhouse gas reporting and financial analysis of carbon risk associated with investments', *Sustainability Accounting, Management and Policy Journal*, Vol. 2 Issue 1, pp.147-157.

<sup>6</sup> See <http://onlinelibrary.wiley.com/doi/10.1111/1759-3441.12114/abstract> for further information on carbon budgets and policy options.

<sup>7</sup> See <http://www.sciencedirect.com/science/article/pii/S0301421512004880> for a literature review of studies of carbon pass through in relation to electricity supply.



energy sector will impact on the pass through of Scope 2-related costs for other businesses.

- What is the domestic elasticity of demand for the product? An assumption made in relation to the domestic elasticity of demand for a product allows an estimate of the incidence of the tax (or tax equivalent) to be made in relation to consumers and producers.
- Is the business import-export competing? Export-import competing businesses are generally price takers and as such the incidence of taxation is likely to almost solely sit with producers (unless competitor countries implement the same taxation regime).
- Will the business receive some form of compensation? Some policies propose some form of transitional assistance (such as the provision of free permits for emissions-intensive trade exposed industries). The value and duration of such assistance needs to be considered in any analysis.
- Does the business use carbon-intensive goods? While Scope 2 emissions provide a useful guide to the additional costs likely in relation to energy procurement, it is necessary to consider how the costs of other carbon-intensive input products (e.g. cement) may change for businesses that use significant quantities.
- Does the business have any upside value? A company that has already invested in lower emitting production equipment will experience a cost advantage relative to its competitors. As prices rise to reflect the costs of its competitors, the company will increase its profit as revenues increase by more than costs. This needs to be considered in any analysis.

It is clear when considering the checklist above that simple metrics for considering 'climate risk' are uneasily obtained. Assessing the impacts of global initiatives to reduce greenhouse gas emissions are inherently difficult as all companies use varying degrees of products that contain 'embedded emissions'. It is important that companies disclose both emissions data and their approach to reducing climate change mitigation and adaptation risk. If done well, reporting through annual sustainability reports and submissions to the Carbon Disclosure Project should provide stakeholders with sufficient information to make a well-informed decision about the risks and opportunities posed by climate change mitigation and adaptation.

#### *AGL greenhouse gas policy*

In April 2015, AGL released a revised greenhouse gas policy. The policy states that AGL will not extend the operating life of its existing coal-fired power stations and not invest in new conventional coal-fired generation. AGL has also recently announced measures to allow for financial innovation in the development of new large scale renewable energy projects (Powering Australian Renewables Fund). Further information on AGL's approach to important issues relating to carbon budgets and policy can be found in the 2015 Sustainability Report<sup>8</sup>, AGL's response to the Carbon Disclosure Project<sup>9</sup> and a recent submission to the Climate Change Authority<sup>10</sup>.

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<sup>8</sup> <http://agl2015.sustainability-report.com.au/>

<sup>9</sup> <http://aglblog.com.au/2015/07/agls-cdp-climate-change-2015-response/>

<sup>10</sup> <http://aglblog.com.au/2016/02/agl-submission-to-the-climate-change-authority-special-review/>



AGL recognises that the electricity generation sector plays a material role in the process of decarbonisation, and as such, is an important participant and contributor to this overarching objective. Should you wish to discuss any aspect of this submission, please contact Cameron Reid on [redacted] or [redacted] or myself at [redacted].

Yours sincerely,

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