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Australian Aluminium Council submission to the Senate Standing Committee on Environment, Communication and the Arts' Inquiry into the Renewable Energy (Electricity) Amendment Bill 2010 [Provisions] and related Bills

The Australian Aluminium Council (AAC) welcomes the opportunity to make a submission to the Senate Standing Committee on Environment, Communication and the Arts' *Inquiry into the Renewable Energy (Electricity) Amendment Bill 2010 (Provisions) and related Bills*.

Key areas that need to be considered in order to ensure the continued viability of electricity-intense industries such as aluminium smelting include:

- **A true 90 per cent exemption from the Renewable Energy Target (RET) for industries that are both electricity- and emissions-intensive. The current proposal only results in an effective 55 per cent exemption from the overall scheme. In its current form, the RET will cost industry an estimated $0.7 – $1.4 billion over the next decade.**
- **Given that the CPRS legislation has been delayed until at least 2013, links between additional EITE assistance under RET being conditional on passage of the CPRS should be removed.**
- **A cap on the quantity of SRECs that can be generated or limit the SRES exposure of EITE industries – thus providing certainty to all investors (small-scale renewable, large-scale renewable and electricity users).**

In our submission to the Senate Standing Committee on Economics in July 2009, the AAC proposed draft amendments to the Bill that would provide incentives for the renewable energy industry whilst minimising harm to Australia's aluminium industry. We have included these draft amendments as an attachment (Attachment A) to this submission for your consideration, as they are still valid in the context of other changes to the Bill.

The AAC would also like to take this opportunity to register its concern regarding the process by which the latest substantial amendments have been brought before the Senate – without any opportunity for public consultation on the legislation.

Given the magnitude of the proposed changes to the overall structure of the scheme it would have been prudent to provide experts, from both the renewable and energy consuming industries, with an opportunity to test legal and technical aspects of the proposed legislation for possible unforeseen consequences – before locking the Bill into the Senate process.

Context

The Australian aluminium industry's relevance to, and interest in, the proposed amendments to the legislation results from:

- The significant impact of renewable energy policy on the international competitiveness of our industry. Council members are the most significant industrial electricity users in Australia.
- The significant levels of investment, employment, production and export income that are at stake. The Australian alumina and aluminium industries have a capital replacement value of over $50 billion, employ around 17 000 people, and produce more than $14 billion of product of which approximately 80% ($11 billion) is exported.
- Our engagement with the development of renewable energy policy generally and specifically on matters relating to the EITE program.

Overall comments on the proposed amendments

INCREASED COSTS TO ELECTRICITY USERS REQUIRES A TRUE 90% EXEMPTION

There have been significant changes to the legislation since it was first introduced in 2000, without any reassessment of the impact of such changes on industry – particularly large energy users. The most recent changes to the RET as contained in the amended legislation will substantially increase the cost of the scheme to electricity users.

Australia's aluminium industry is the most exposed industry in terms of electricity costs. Therefore the proposed level of exemption needs to be increased in order to minimise the impacts of the legislation on large energy users. A 90 per cent exemption from the overall scheme (including the original 9,500 GWh) should be considered and is examined further below.

Splitting the RET into LRET and SRES has been structured so that the combined renewable energy target cannot be less than the previous RET target, but has potential to be significantly greater.

Furthermore, the cost of implementing any amount of renewable energy can only be greater by splitting it into two separate targets. This increase is likely to be significant as the cost of large scale renewable energy is substantially higher than small-scale, as the latter is subsidised by rebates and feed-in-tariffs, under current arrangements. This price difference, and the impact it was having on investment in large scale renewable energy, is the rationale behind the proposed split.

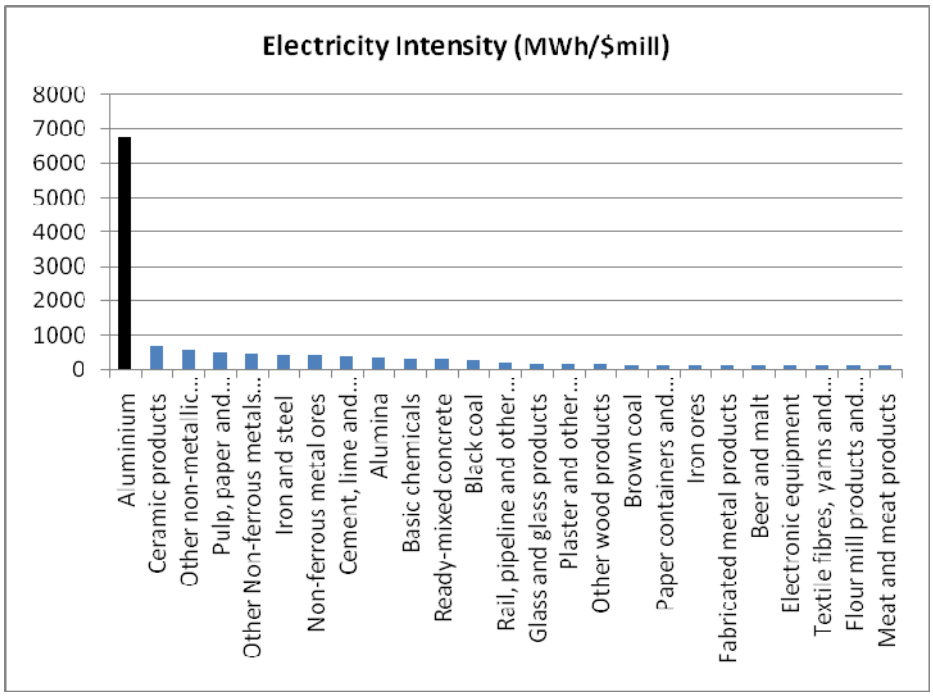
The most recent legislative changes are motivated to improve returns to investors in large scale renewable energy (relative to the existing scheme) and reduce the level of uncertainty for the same investors. However, there is no reduction in uncertainty overall in the scheme or additional funds from Government. The uncertainty and costs have simply been shifted from investors in large scale renewable energy to electricity users and investors in industries that use electricity.

RET costs also have the potential to be higher in the future due to the likely implementation of an emissions trading scheme (ETS) post 2013. Were an ETS to be introduced, the RET and the ETS combined would lead to electricity prices high enough for large-scale renewable electricity generation to be viable.

However, if the ETS does not pass, the RET still requires a certain proportion of electricity generation to be from (large-scale) renewable energy. The LREC price will therefore increase well beyond current levels[1]. The EITE exemptions under RET must be strengthened so that they deliver an effective level of exemption – a true 90 per cent for electricity intensive industries.

[1] Many experts are predicting the LREC price will reach the current shortfall charge which is equivalent to $92 after tax.

Australia's aluminium industry is the most exposed industry in terms of electricity costs as indicated by DCC's own analysis.



As part of the changes to the RET scheme, the Australian Aluminium Council calls on the Government to change the treatment of EITE industries under RET to reflect the extra costs being imposed by these proposed changes.

Specifically, we call for a true 90 per cent exemption from all RET costs for electricity-intense activities such as aluminium smelting, rather than what is currently an effective 55 per cent partial exemption rate. The Government may consider extending this treatment to other EITE activities.

The Bill in its current form is estimated to cost the Australian aluminium industry between $0.7 - $1.4 billion over the first decade of the scheme - costs that will not be paid by producers in other countries[2].

Linkage of Partial Exemptions to the CPRS

Part of the additional EITE assistance proposed by Government in the RET regulations - in relation to the first 9,500GWh and REC prices above $40 - will only come into effect if the CPRS legislation is passed by both houses of parliament. Specifically:

(4)For paragraph (3) (b), the specified circumstances are as follows:

(a) the *Carbon Pollution Reduction Scheme Act 2010* has received the Royal Assent;

(b) the year is 2011 or a later year;

(c) the estimated REC price is greater than $40[3].

The proposed legislation changes impact both on the RET base (9,500GWh target) as well as the extended RET target. Given that the CPRS legislation has not received the Royal Assent and seems unlikely to be considered until at least 2013, this linkage should now be removed and the necessary additional assistance written into the RET regulations. This will minimise the impact of the enhanced RET on the competitiveness of RET affected, trade-exposed (RATE) industries.

Links between additional assistance under RET being conditional on passage of the CPRS should be removed.

[2] This is based on McLennan Magasanik Associates, Report to Department of Climate Change, Benefits and Costs of the Expanded Renewable Energy Target, January 2009. If the LREC price was to reach the shortfall charge this would increase to approximately $1.4 billion.

[3] Part 3A, Division 5, Subregulation 4 - Renewable Energy (Electricity) Regulations 2001 (27 March 2010)

STRUCTURE OF LRET AND SRES TARGETS

The Explanatory Memorandum to the legislation notes the risks regarding the recommended Option 3 (41,000 GWh large-scale target plus the amount of small-scale generation induced by the fixed price regime) as *"...the possibly open-ended commitment to small-scale generation with cost impacts for the liable entities."*[4]

The uncertainty created by this approach and the one-sided nature of the consideration – in favour of investors in renewable energy generation and against investors in energy use – are without justification and, as noted, simply increase the uncertainty and costs faced by all electricity consumers.

This uncertainty could be avoided by capping the SRES pool or limiting the exposure of highly electricity intensive EITE activities to the SRES. This would provide certainty to all investors (small scale renewable, large scale renewable, and electricity users) whilst achieving the policy outcome (investment in renewable energy) and remove the need for a review with the associated uncertainty this creates.

Whilst capping the quantity of SRECs that can be generated would remove a level of certainty for industry, this alone would not be enough to minimise the costs imposts associated with other aspects of the legislation.
Capping the quantity of SRECs that can be generated must be implemented in conjunction with a true 90 per cent exemption from the full RET scheme for EITE industries or, at a minimum delinking of the additional price-cap assistance from the CPRS legislation.

REVIEWS AND POLICY CHANGES

The proposed approach to mitigate the risks associated with Option 3 calls for *"...monitoring the uptake in the market and reviewing the fixed price in 2014. In addition, annual targets could be set with a 'true-up' in the following year."*[1]

Once again, this review is a source of risk and uncertainty for liable entities and electricity users. Furthermore, there are no measures proposed against which the review will assess what level of uptake of SRECs is considered appropriate or what criteria will be used to assess "possible mechanisms".

If there is to be a review in 2014, there should be much better definition of the desired policy outcomes and the measures against which good policy can be assessed. These must consider the magnitude and structure of costs being imposed on electricity users and the concept that more small scale renewable energy comes at a cost and may not always be the optimal outcome.

The proposed 2014 review and the potential for changes to the scheme flowing from the current COAG review, will come soon after the current proposed changes which are being proposed less than 12 months after the scheme was expanded. These rapid changes in policy create negative outcomes for both energy suppliers and users. With each review the policy is becoming more complex and costly, and less efficient in achieving the policy outcomes. A more disciplined policy approach is required if stable markets are to be created for energy supply and energy using industries.

CONSISTENCY WITH GOVERNMENT POLICY

The changes that the AAC is calling for are consistent with previous Government proposals (as well as recent Government decisions) and are justified by Government analysis and statements on the issue, as evidenced by the following.

RET will impact on electricity-intensive industries that can't pass on costs. The Government has always acknowledged that some industries cannot pass on increased electricity costs to customers:

> "The RET is likely to impact most upon electricity-intensive industries that are unable to pass through the full costs associated with the RET, for example where prices are set in international markets"[5]

[4] Renewable Energy (Electricity) Amendment Bill 2010 - Explanatory Memorandum (pg 8)

[5] Treatment of electricity-intensive, trade-exposed industries under the expanded national Renewable Energy Target scheme, Discussion Paper, November 2008

Exposure to RET is best measured by the cost of electricity as a proportion of revenue. The Government acknowledged that electricity cost as a proportion of a product's revenue was the best indicator of vulnerability to RET costs:

> "Assessing materiality for assistance under the RET therefore requires a specific, electricity-related threshold test. Electricity intensity of production, would serve as an appropriate indicator of materiality for comparison across different areas of industry in determining RATE activities."[6]

Aluminium is far more vulnerable than any other activity – it is the only significant activity that is emissions-intensive and electricity-intensive. Aluminium smelting has electricity intensity far higher than any other activity:

> "Preliminary analysis of electricity intensities at industry level, expressed per unit revenue indicates that aluminium stands out strongly as the most substantial electricity intensive industry, being an order of magnitude higher than the next rung of industries." [6]

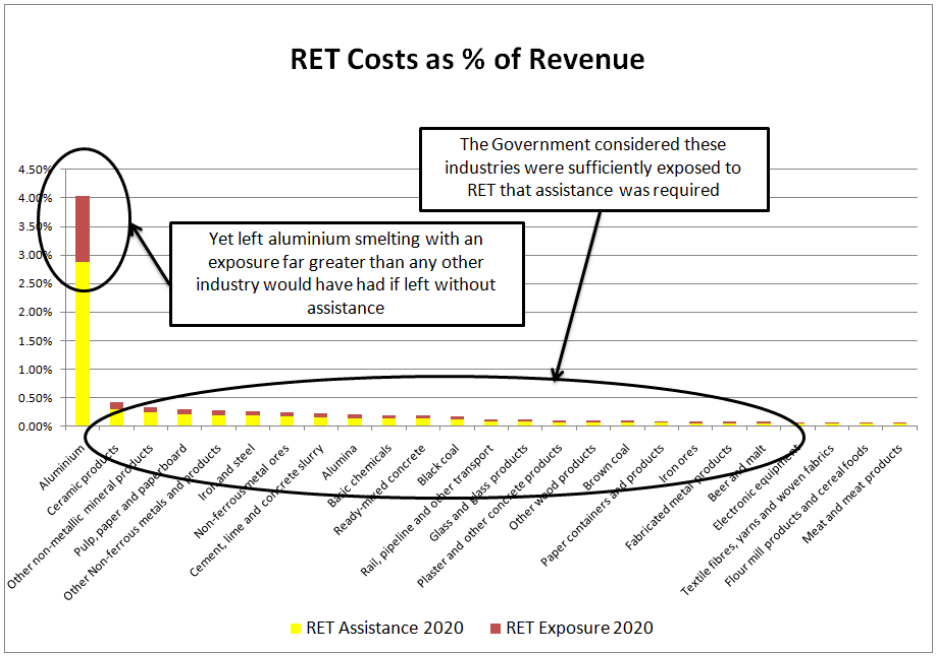
> "the RET cost as a proportion of revenue in 2013 would be in the order of 1.5 percent for the aluminium industry, rising to around 4 percent in 2020. This contrasts with the next rung of industries where the RET burden would rise from around 0.2 percent in 2013 to around 0.4 percent in 2020"[6]

The costs of RET and the CPRS will be cumulative. The Government altered its proposal to take into account the combined impact of RET, CPRS and the global financial crisis:

> "COAG also agreed to provide partial exemptions to emissions-intensive, trade-exposed industries. COAG recognised the impact of the RET on trade-exposed industries in the context of the CPRS and the additional pressures these firms are experiencing as a result of the global financial crisis."[7]

RET costs of 0.2% to 0.4% of revenue are significant and warrant exemption. By extending the proposed assistance to all emissions-intensive, trade-exposed industries under the CPRS, the Government acknowledged that a RET cost of 0.2% to 0.4% of revenue warranted an exemption:

> "Assistance to electricity-intensive, trade-exposed industries (otherwise known as RET-affected, trade-exposed or RATE industries) mirrors the differentiated rates of assistance for all emissions-intensive, trade-exposed (EITE) industries under the Carbon Pollution Reduction Scheme (CPRS)."[8]



[6] Treatment of electricity-intensive, trade-exposed industries under the expanded national Renewable Energy Target scheme, Discussion Paper, November 2008

[7] Prime Minister's Press Release - Coordinated National Action to Drive Energy Efficiency and Renewable Energy Uptake -30 April 2009

[8] Renewable Energy Target Scheme Design – COAG Announcement 30 April 2009

RET costs for these EITE industries (other than aluminium) are no higher than 0.2% to 0.4%:

> "... industries where the RET burden would rise from around 0.2 percent in 2013 to around 0.4 percent in 2020"[6]

The proposed 90% exemption is only from expansion of the RET target, not the extension of the base. While it is being referred to as a "90% exemption", it is actually only a 90% exemption from the expansion of the RET target to 45,000 GWh. There is a full exposure to the continuation of the RET base of 9,500 GWh:

> "Assistance will only be for the RET liability that relates to the expanded portion of the annual target (that is, the amount of the target above the 9,500 GWh...)"[3]

Aluminium smelting is an EITE industry yet is left with a RET cost exposure far greater than 0.4%. The electricity intensity of aluminium smelting, combined with continued exposure to the RET base 9,500 GWh, plus a 10% exposure to the expansion to 45,000 GWh, totals to a cost exposure significantly in excess of 0.4% of revenue (approximately 1%). Yet this was the level of cost exposure that the Government has already determined is too great to be imposed on other activities.

An exemption that is equivalent to that being provided to other activities can be achieved with 90 per cent exemption from full RET. The RET costs imposed on the aluminium smelting industry can be reduced to the levels deemed appropriate for other activities through **a true 90 per cent exemption from the full RET**. This is a relatively simple change to the proposed legislation; is compatible with providing strong incentives for the development of a renewable energy industry; and would still see the aluminium smelting industry paying substantially more in RET costs over the next ten years.

As stated in previous submissions on this matter, the Council stresses its support for simple, clear, market-based measures to efficiently address emissions reductions and the development of renewable energy. The current plethora of state and Commonwealth based schemes and even the inefficiencies that are created at a Commonwealth level through renewable energy policies, energy efficiency policies and likely emissions reductions policies do not create a simple, clear and efficient market signal.

Thank you for the opportunity to provide comments on the proposed legislation. Please contact me if you have any questions.

Yours sincerely,

MILES PROSSER
EXECUTIVE DIRECTOR
AUSTRALIAN ALUMINIUM COUNCIL

ATTACHMENT A

PROPOSED AMENDMENTS TO THE *RENEWABLE ENERGY (ELECTRICITY) AMENDMENT BILL 2010*

These amendments have been designed to achieve three things:

- A 90% exemption from the full RET for activities that are both highly emissions-intense and also electricity-intense. This is probably aluminium smelting and silicon production only.
- Reducing the reliance of the RET exemptions on passage of the CPRS legislation. This has meant changing the start date (that was linked to CPRS), changing the definition of EITE (that was also linked to CPRS) and changing references to the "Authority" (established under the CPRS) to the "Regulator" (that already exists for the current RET).
- Bringing in some of the detail of the EITE program into the legislation to provide some certainty.

Renewable Energy (electricity)
Amendment Bill 2010
No. , 2010
(Climate Change and Water)

1) Clause 2, page 2 (table item 3), omit the table item, substitute:

3. Schedule 2	A single day fixed by proclamation. However, if the provision(s) do not commence before 1 July 2010, they commence on that day.

2) Schedule 2 , item 2, page 7 (lines 14 to 16), omit the definition of ***emissions-intensive trade-exposed activity***, substitute:

emissions-intensive trade-exposed activity - See section 38D.

3) Schedule 2, item 2, page 7 (lines 17 to 21), **remove item.**

4) Schedule 2,item 8, page 9, after Section 38C, insert:

38D Regulations

(1) The Governor-General may make regulations for the purposes of:
  (a) identifying emissions-intensive trade-exposed activities; and
  (b) classifying such activities as:
    (1) both highly emissions-intensive (>2000 t CO2-e / $million revenue) and electricity intensive (>4000 MWh / $million revenue); or
    (2) highly emissions-intensive (>2000 t CO2-e / $million revenue); or
    (3) moderately emissions-intensive (1000-2000 t CO2-e / $million revenue); and
  (c) prescribing all matters necessary or convenient to be prescribed for carrying out or giving effect to the matters in paragraphs (a) and (b).

(2) The regulations are to ensure that the activity consisting of the physical and chemical transformation of alumina (aluminium oxide, Al_2O_3) into saleable aluminium metal (Al) is classified as an activity which is both emissions-intensive and electricity intensive.

(3) The regulations are to provide that the amount of the partial exemption stated in a partial exemption certificate is as follows:
  (a) for an activity which is both highly emissions intensive and electricity intensive—90% of the total liability;
  (b) for a highly emissions-intensive activity—90% of the expanded liability;

(c) for a moderately emissions-intensive activity—60% of the expanded liability.

(4) The Minister must take all reasonable steps to ensure that regulations are made for the purposes of subsection (1) before 1 July 2010.

(5) In this section:

expanded liability means, in relation to an activity, a liable entity's additional liability for the renewable energy shortfall charge that would be incurred as a result of the enactment of the *Renewable Energy (Electricity) Amendment Act 2009*, including the entity's entire liability for the renewable energy shortfall charge in respect of the period commencing on 1 January 2021, but for the liable entity's partial exemption.

total liability means, in relation to an activity, a liable entity's liability for the renewable energy shortfall charge that would be incurred but for the liable entity's partial exemption.

5) Omit references to "**Authority**" (wherever occurring), substitute "**Regulator**".