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By email to CarbonPriceSubmissions@climatechange.gov.au

Dear Multi-Party Committee Members,

Carbon Price Mechanism

AGL Energy welcomes the opportunity to comment on the Multi-Party Climate Change Committee *Proposed Architecture and Implementation Arrangements for a Carbon Pricing Mechanism*. AGL is a strong supporter of the introduction of an Australian emissions trading scheme with an effective long-term emissions reduction target as its goal.

AGL Energy (AGL) is the leading investor in renewable energy in Australia. AGL operates across the supply chain and has investments in coal-fired, gas-fired, renewable and embedded electricity generation and electricity retailing. AGL is Australia's largest private owner, operator and developer of renewable generation in Australia with 1,073 MW of renewable capacity (at 30 June 2010). AGL is also a significant retailer of energy with over 3 million electricity and gas customers.

AGL is well placed to comment on the concept of carbon pricing due to the diversity of our business. There will be a number of impacts on AGL as a result of the implementation of a carbon price on the AGL business. These can be summarised as: increased wholesale costs; compliance costs; and investment incentives.

- Increased Wholesale Energy Costs: AGL is one of Australia's largest retailers of electricity and gas. In 2009/10, the greenhouse gas emissions produced in association with the supply of AGL customers totalled 47.3 million tonnes. This is around 9% of Australia's total greenhouse gas emissions. While AGL will not be required to pay a carbon price for all these emissions, we will be required to pay higher costs for energy as generators and gas producers pass through carbon costs in the form of higher energy contract prices. At a carbon price of $20, this is likely to result in an increase in wholesale energy costs of close to $1 billion.

- Compliance Costs: Based upon our understanding of the likely direction of the carbon price mechanism in relation to natural gas supply, AGL will be responsible for paying a carbon price associated with the greenhouse gas emissions produced as a result of the combustion of natural gas by our residential and small business customers. At a carbon price of $20, this is likely to result in an increase in compliance costs of around $200 million.

- Investment Incentives: If appropriately implemented, a carbon price will provide policy certainty in relation to climate change policy within the electricity sector and facilitate investment in new low emission generation. Power stations generally have asset lives of several decades and certainty about their long-term prospects is vital to secure capital. The introduction of a robust carbon pricing framework will allow energy

companies like AGL to confidently integrate carbon pricing into business decision making and invest capital in these types of long-life assets.

AGL has already commenced putting in place systems and processes for managing these risks and opportunities. This is largely because emissions trading was a key election commitment of both major parties in the lead up to the 2007 Commonwealth election. AGL believes it would create significant regulatory uncertainty and sovereign risk if a carbon price is not introduced in the short-term as the primary policy mechanism to deliver the bi-partisan 5% emission reduction goal for 2020.

AGL's climate change policy is outlined in the board-approved AGL Greenhouse Gas Policy (a copy is provided at Attachment 1). The principles for policy development articulated in the policy are very similar to those proposed by the Multi-Party Committee. The policy outlines that AGL supports four key policies to achieve the proposed bipartisan emission reduction target and mitigate the costs associated with climate change and related health impacts:

- Expedited development and implementation of a national emissions trading scheme which uses broad, long-term (multi decade) GHG emission reduction targets as its goal;
- The deployment of renewable technologies through a single national clean energy obligation;
- All existing State-based energy efficiency obligations must be amalgamated into a single national energy efficiency obligation; and
- Appropriate adaptation measures to ensure that Australia is not adversely impacted by existing GHG concentrations in the atmosphere.

Broad architecture of the carbon price mechanism

In response to the issues raised in the *Proposed Architecture and Implementation Arrangements for a Carbon Pricing Mechanism*:

- AGL strongly supports the introduction of a carbon price on 1 July 2012. AGL notes that the carbon price required to substitute new coal-fired electricity generation for combined cycle gas-fired generation is around $20 to 30 per tonne of carbon dioxide equivalent[1] (this is, however, dependent upon long-term coal and gas prices in Australia);
- The length of the fixed price period should be as short as possible. AGL believes that a market mechanism (rather than a fixed price) is a preferable position but understands the need to transition from a fixed price to an emissions trading scheme;
- AGL supports the concepts outlined by the Multi-Party Committee in relation to how a transition to a full emissions trading scheme would be achieved;
- In the absence of future emission reduction targets being agreed by the Multi-Party Committee, AGL believes that the initial fixed price should be set as a "floor" for at least 10 years into the future to provide the requisite policy certainty for investment in new electricity generation[2];
- The concepts relating to coverage are supported by AGL. At the very least, the electricity generation sector should be included from 1 July 2012. As outlined in the following section, AGL does not support alternatives to cap and trade forms of emissions trading being applied to the electricity sector; and

[1] Based upon LRMC of CCGT of around $60/MWh and emissions intensity of 0.4 tonnes per MWh and LRMC of new coal of around $50/MWh and emissions intensity of 0.8 tonnes per MWh

[2] AGL economists conclusively demonstrated that uncertainty in relation to carbon policy will result in inefficient investment and higher electricity prices. The research was published in Economic Papers and is available at: http://onlinelibrary.wiley.com/doi/10.1111/j.1759-3441.2010.00084.x/abstract

- AGL supports the concepts outlined by the Multi-Party Committee in relation to the use of international permits.

Specific comments on the electricity sector

AGL strongly supports the concept of an "Electricity Sector Adjustment Scheme". Such a scheme was proposed by the three main proposals for emissions trading considered over the past 10 years: the State-based National Emissions Trading Task Force (NETS); the Prime Minister's Task Group on Emissions Trading; and the Carbon Pollution Reduction Scheme. The rationale for such a scheme is clear. Over the past ten years, there have been a number of studies completed by businesses, governments, industry associations and non-government organisations on the impacts of carbon pricing on coal-fired power station asset values. Losses for National Electricity Market generators have been modeled at $11.0 billion by ACIL Tasman (2011); $16.7 billion by ACIL Tasman (2008); $17.5 billion by ROAM (2008); and $0.1 billion by MMA (2008). Privately owned brown coal generators have been forecast to experience losses of $7.1 billion, $7.9 billion and $2.3 billion in the respective 2008 studies. Based upon these results, it is not surprising that the structural adjustment assistance proposed under the Carbon Pollution Reduction Scheme in 2008 by the Commonwealth Government involved $7.3 billion in nominal terms.

Two economists within AGL recently published a new working paper examining the public policy rationale for the provision of structural adjustment assistance to privately-owned coal-fired generators. The study (Attachment 2) found that there is a clear rationale for the provision of a limited number of free emissions permits within an emissions trading environment for multiple reasons. Most importantly, in the absence of structural adjustment assistance being provided, economic efficiency losses of $1.6 billion per annum in 2020 and $8.6 billion in aggregate over the period 2015-2020 would materialise due to higher risk premiums being applied to the financing of all new electricity generation investment. Such an outcome is clearly unacceptable from a policy and welfare perspective.

Based upon the findings of this and earlier research, AGL urges the Multi-Party Committee to ensure that the carbon pricing framework implemented utilises the previous "Electricity Sector Adjustment Scheme" as its starting point for the quantum of structural adjustment assistance to incumbent privately owned coal fired electricity generators.

Other recommendations in relation to climate change policy

There have been many erroneous claims made in relation to the impacts of carbon pricing on retail electricity pricing. Economists within AGL have undertaken detailed research which indicates that the impact of a carbon price is likely to be relatively immaterial relative to other price drivers over the next five years[3]. That said, AGL believes that energy efficiency can play a significant role in minimising any cost impacts on consumers associated with the introduction of a price on carbon. The South Australian, New South Wales and Victorian Governments have already implemented residential energy efficiency schemes and the QLD Government is understood to be considering the merits of implementing a similar scheme. A national approach to energy efficiency policy is likely to provide significant benefits for residential and commercial and industrial consumers of energy. AGL encourages the Multi-Party Committee to consider how an amalgamation of these state-based schemes into a national policy could be achieved.

It is critical that the Multi-Party Committee become engaged in the policy framework for regulation of electricity and gas prices for residential and small business customers. The continued regulation of electricity and gas prices by State governments is likely to be a major impediment to the achievement of objectives related to the introduction of a carbon price. Unless prices for electricity and gas are able to reflect the true cost of carbon, customers will not be able to respond to price signals. As such, AGL believes that the Multi-Party Committee should consider options for incentivising State governments to remove regulation of electricity and gas retail pricing.

Conclusion

[3] For further information, see Simshauser, P., Nelson, T. and Doan, T., (2011) "The Boomerang Paradox Part 1: how a nation"s wealth is creating fuel poverty", *The Electricity Journal*, 24(1): 72-91.

It is critical that a carbon pricing framework be implemented as quickly as possible. There are already significant costs being imposed upon the community as a result of the uncertainty being created by the ongoing discussion about a carbon price and its potential start date. Investors will not be able to proceed with new intermediate and baseload power station projects until the details of the pricing framework are finalised. As these projects have significant development timeframes (several years from concept to operation), it is critical that the legislative framework underpinning the price be finalised to allow companies like AGL to work towards providing a secure and stable energy supply for our customers.

Should you have any questions in relation to this submission, please contact me at tnelson@agl.com.au or on (02) 9921 2516.

Yours sincerely,

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