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29 April 2011

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The Secretary
Senate Select Committee on The Scrutiny of New Taxes
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Committee Secretary,

RE: Submission to the Committee review of the proposed Carbon Tax.

In response to a written request from the Secretary of the Senate Select Committee on the Scrutiny of New Taxes (the 'Committee'), Griffin Energy ('Griffin') welcomes the opportunity to make a submission to your current line of inquiry.

Griffin Energy is involved in the generation and sale of electricity in the Western Australian Electricity Market (WEM). Griffin notes that the terms of reference of the Inquiry are fairly broad. This submission is focussed on term (d) *the likely effectiveness of these taxes and related policies in achieving their stated policy objectives;* and how this relates to Griffin's electricity generation activities.

The main policy objective of the proposed carbon tax is (or at least should be) the placing of a price on carbon emissions that will, over time, transition Australia's energy and hence emissions intensive economy to one less emissions intensive. This should include both the use of energy (i.e. efficiency) and the emissions intensity of the energy used. The problem with these types of policy goals is that the success in achieving them is very much impacted by the implementation of the regulation and reform designed to drive them. The introduction of the 20% MRET legislation is a good example of poor implementation. In that example, the initial inclusion of small scale renewable sources along with utility scale facilities has seen such a surplus of (small scale) RECs that the expected utility scale facilities have not been able to proceed. This is because the two types of renewable generation (small scale and utility scale) have very different commercial drivers. Small scale renewables are very flexible. New competitors can spring up overnight and be installing rooftop solar PV, sourced from China, immediately. Each new facility is commercially viable once the installation is complete. Utility scale renewables, such as a wind farm, require years of planning, years of

construction, and 10 to 15 years of reliable commercial operation to be viable. In other words, each sector requires a distinct policy implementation to cater for the unique conditions.

The South West Interconnected System (SWIS), which is covered by the WEM, is an isolated electricity grid. As such, it is structured to maintain reliability and security of supply, including operating a capacity and energy market; and ensuring a diverse portfolio of fuel sources. Coal fired generation represents around 40% of the installed capacity in the SWIS. This share is expected to be eroded over time. However, it is recognised that in the absence of another base load supply source (such as nuclear or geothermal power), some coal generating capacity will be required into the foreseeable future to insure against gas supply disruptions (gas being the major fuel source in the SWIS).

The WEM is not connected to or related to the National Electricity Market (NEM). The form of market governing the operation of the WEM is very different to the NEM. And the fuel mix of the WEM differs substantially from the NEM. In the NEM, over 80% of electricity generation comes from coal. Within this mix, brown coal competes with black coal. The addition of a price on carbon has a specific impact on this competitive dynamic, with the more emission intensive brown coal generation affected to a greater extent than black coal generation. Additionally, the gross pool market mechanisms and retail hedging arrangements mean that these impacts will present to the wider economy in a specific manner.

There is no brown coal generation in the WEM. Black coal competes with gas fired generation (which makes up around 60% of generation capacity in the SWIS). Additionally, given the lack of liquidity in the only energy trading mechanism in the WEM, base load generation facilities cannot be financed on a 'merchant energy' basis, hence have been project financed, backed by long term bilateral supply contracts. This means that any compensation for electricity generators that is based on competition between brown coal and black coal (as was originally envisioned in the CPRS – ESAS design) will inevitably result in unintended consequences for the WEM. There are already signs of such consequences. Based on the expectation that no new private coal fired power stations will be built in the WEM – a result of financiers struggling to overcome sovereign risk issues due to existing investments being impaired by no (or inadequate) compensation[1] – the state government, by way of the state owned generation utility, is recommissioning the previously retired Muja AB power station in Collie. Muja AB is one of the oldest and most emission intensive power stations in Australia. Its refurbishment will not improve its emissions intensity to any comparable level of an efficient new technology coal fired facility and it will be brought back into operation as one of the highest CO2 emitting power stations in the country[2]. In terms of emissions reduction and transitioning the economy away from older emission intensive technology, this represents a perverse policy outcome. More concerning from the perspective of the WEM is the intervention of the state government into the competitive market for new generation supply. To allow the recommissioning of Muja AB, the Minister for Energy has had to exempt the facility from the mandated 3,000MW cap on the dominant state owned generation utility. This is likely to have a significant impact on how prospective new entrant generators

[1] Previously financed coal fired power stations, prior to June 3 2007 when bipartisan support for and emissions trading scheme was achieved, were not subject to a carbon price. At worst, under both the proposed NETTS scheme and the Primer Minister's Taskforce into Emissions Trading proposal, new coal fired power stations would be compensated by an amount equivalent to their 'disproportional loss of asset value'. To change the goalposts on the implementation of a carbon price would represent a significant cost to those providers of capital of now impaired assets. This will manifest in increased costs of finance for new assets, or sovereign risk.

[2] Additionally, SO2 emissions will be almost twice the level of the newest coal fired facility in the Collie region.

view ‘competition’ in the WEM. A lessening of competition resulting from poorly implemented policy would represent another poor outcome.

As Griffin has previously argued, if it is considered that Australia needs a price on carbon in the immediate future in order to begin its transition to a less carbon intensive economy, then the impacts of the implementation of such a policy needs to be carefully considered. This will not be an easy task by any means, but significant structural adjustments to a well established economic order rarely are. At the very least, when designing compensation arrangements for coal fired generators, which have provided much of the benefit of low cost energy on which Australia has built its comparative advantage, any final design should give consideration to the relative emission intensities of the two very distinct markets in which they operate.

Should you have any questions regarding our comments, I can be contacted on 08 9261 2908; shane.cremin@thegriffingroup.com.au

Yours sincerely

Shane Cremin
GM – Policy & Strategy