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Committee Secretary  
Joint Select Committee on Australia's Clean Energy Future Legislation  
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### **Clean Energy Future legislative package**

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Joint Select Committee on Australia's Clean Energy Future (CEF) Legislation.

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of over 40 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ over 52,000 people and contribute \$16 billion directly to the nation's Gross Domestic Product.

On 22 August 2011 the Association provided comments and feedback in a joint submission with the Energy Retailers Association of Australia on the exposure draft legislation to the Department of Climate Change and Energy Efficiency. esaa is disappointed to see few of its proposed changes reflected in the Clean Energy Future Legislation introduced to Parliament on 13 September, including its concerns on substantive policy issues. However, the Association is pleased that at least some of the proposed implementation and drafting changes have been included in the revised legislation. This submission will reiterate esaa's concerns about the bills, as well as propose additional amendments to further improve the legislation where changes have been made.

In response to the policy positions in the exposure draft legislation, esaa commissioned modelling analysis of the potential impact of the Clean Energy Future package on the electricity contracting market and how this would impact electricity prices. The analysis, by ACIL Tasman, found that the design of the scheme could lead to increased volatility in the electricity market along with retail electricity price rises (*in addition* to the price rises resulting from the introduction of the carbon price) of at least 10 per cent in a single year for small users (households and small businesses) and up to 15 per cent for large users. This added risk to energy prices could be addressed by amending the legislation to provide appropriate arrangements for permit auctions that allow parties to pay for permits when they are required – the actual year of emissions – rather than paying the Government years in advance. The

ACIL Tasman modelling report is attached to this submission and is discussed in more detail below in Section 2 on auction design and the working capital burden.

### **Executive summary**

The stationary energy industry supports the development and implementation of a well-designed emissions trading scheme (ETS). Despite some welcome improvements in the *Clean Energy Bill 2011* as introduced to Parliament compared to the exposure draft legislation, esaa considers there remain serious deficiencies with the scheme. This submission outlines the industry's five key concerns with the scheme, which require the Government to:

1. Adequately address the stranding of coal-fired generation assets. A more measured transition to full auctioning of carbon units (as proposed in most other schemes around the world to date) would enable a greater volume of carbon units to be administratively allocated to affected generators to ensure there is no disproportionate loss of economic value on the sector's balance sheets or a rise in costs to such a level as to compromise both the ability to refinance, and/or re-invest in existing power plant;
2. Ensure there are no additional working capital requirements for liable entities from the operation of the *Clean Energy Bill 2011*, including from taxation and auctioning;
3. Provide longer term certainty to the sector by committing to ten years of rolling scheme caps followed by a ten-year rolling gateway. This is necessary to support the development of the emissions market in Australia and because global emissions prices do not provide sufficient long term information in isolation;
4. Cover the greatest proportion of greenhouse gas emissions possible. Measures that only target a subset of sectors of the Australian economy are unlikely to lead to least cost abatement; and
5. Ensure retail price regulation is removed for electricity and gas. Efficient prices are necessary to provide the appropriate signals for consumption and new investment and without full cost pass-through the viability of retailers and the entire electricity and gas supply industry is at risk.

The submission also addresses a number of new issues that emerged in the legislation that were not identified in the Clean Energy Future policy document, as well as providing direct comment and feedback on the drafting of the legislation. Issues discussed include:

- the carbon pollution cap, including developing a more appropriate default trajectory and developing regulations setting the cap as soon as possible, rather than by May 2014;
- the mechanics of liable entities, including clarifying a range of issues with respect to gas liability and increasing the flexibility of the joint venture provisions;

- the treatment of coal-fired electricity generation, including providing greater certainty on how the Energy Security Fund, and the Power System Reliability Test are to be implemented, as well as removing the proposed time limits for loans to affected generators;
- auction design, including consultation on developing the details of auctions and clarifying that auctions will not be cleared on a pay-as-bid basis;
- removing the international unit surrender charge, due to it artificially increasing the marginal cost of overseas abatement and its detrimental impact on the development of international abatement markets and scheme participants. Options for implementation to minimise its effect are also discussed;
- the need to improve transitional arrangements for when certain international units are prohibited from being surrendered in the scheme;
- information-gathering powers and monitoring powers, including that powers should be contained to circumstances where the Regulator has a reasonable belief that breach or non-compliance has occurred;
- taxation, including clarity on the treatment of deductions, the same business test and the non-levying of stamp duty on the transfer of emissions units;
- unit shortfall charge, including that the proposed non-deductible charge of 200% of the benchmark average auction price is overly onerous; and
- governance arrangements, including calling for details on how the Energy Security Council will operate and for further detail to help industry understand the impact of the Clean Energy Finance Corporation (CEFC) on electricity markets.

The industry notes that there is still a considerable amount of detail to be included in legislative instruments. Consultation on these issues needs to begin as soon as possible in order to ensure high quality results.

## **Introduction**

The stationary energy industry currently produces over 37 per cent of Australia's greenhouse gas emissions and will be significantly impacted by the introduction of a new charge on greenhouse gas emissions. As Australia's largest source of emissions, the energy industry has engaged keenly in the national conversation on greenhouse policy. esaa wishes to record its appreciation of the level of engagement by the Government and officials through various policy consultation forums in the lead up to the announcement of the Clean Energy Future package on 10 July 2011.

However, the nature of this engagement meant that it was not clear until its release exactly what the policy package, in its entirety, would look like. Many aspects of the policy were presented for the first time at that point and no opportunity was given for formal consultation. The exposure draft legislative package released on 28 July 2011 also contained further new details. This contrasts with the development of the Carbon

Pollution Reduction Scheme (CPRS), which involved a full Green and White Paper process.

Further, the time period afforded to stakeholders to examine the exposure draft legislation was insufficient given the size of the package and the significance of the policy. Similarly, the amount of time provided for submission to the Joint Select Committee since the introduction of the Clean Energy Future legislation into Parliament is so limited as to virtually preclude new analysis. Lack of substantial consultation on policy detail and tight timeframes increase the chances of unintended outcomes and are not conducive to sound, enduring policy outcomes. However, given that the legislation identifies a number of areas where important detail is to be developed in subordinate instruments, esaa looks forward to engaging closely at that point to ensure that the needs of the energy industry are reflected.

esaa considers that the implementation of a well-designed national emissions trading scheme (ETS) is a critical measure for ensuring investor confidence in the energy sector. A well-designed ETS must be efficient, effective and equitable in the long term and, importantly, must ensure a smooth and orderly economic transition in the short-to-medium term. Failure to ensure an orderly transition could have widespread and potentially long lasting adverse economic impacts.

As a small, open economy, with a relatively high cost of abatement, an Australian ETS will be highly influenced by developments in international greenhouse policy. Since the development of the CPRS, the international environment has changed. The Kyoto Protocol expires after 2012 and there is no binding global agreement to limit emissions in place to succeed it. This clouds the outlook for international abatement and future linkages with overseas carbon markets, which in turn underscores the importance of a well-designed Australian ETS that maximises flexibility and efficiency and enables Australia to achieve its emissions reduction goals at least cost.

There are some welcome improvements in the *Clean Energy Bill 2011* compared to the architecture document released on 24 February 2011 by the Multi-Party Committee on Climate Change, such as the commitment to a preset limit on the fixed price period and the change of the point of liability to reflect operational control. Similarly, additional improvements have been made in the bills following consultation on the exposure draft, such as clarifying the obligations of generators entering into a contract for closure in relation to the Power System Reliability Test and the Clean Energy Investment Plan. These changes demonstrate the importance of consultation between Government and affected parties and will contribute to the effectiveness and efficiency of the scheme.

Notwithstanding these improvements, the Association considers that there remain serious deficiencies with the scheme. Not only do the industry's four primary concerns with the CPRS essentially still hold, but the industry is also concerned by the reduction in coverage of the scheme.

This submission firstly outlines these five critical issues. It then addresses a number of new issues that emerged in the legislation that were not identified in the Clean Energy Future policy document, as well as providing direct comment and feedback on the drafting of the legislation. To support this commentary, a detailed table is

attached that provides specific clause by clause detail on the drafting issues raised and other items identified by the industry.

### **The industry's five critical issues with the Clean Energy Future package**

The stationary energy industry supports the development and implementation of a well designed ETS. The industry's five critical issues that need resolving in order to ensure the security of supply and investor confidence in long-lived, capital-intensive assets, require the legislation to:

1. Adequately address the stranding of coal-fired generation assets. A more measured transition to full auctioning of carbon units (as proposed in most other schemes around the world to date) would enable a greater volume of carbon units to be administratively allocated to affected generators to ensure there is no disproportionate loss of economic value on the sector's balance sheets or a rise in costs to such a level as to compromise both the ability to refinance, and/or re-invest in existing power plant. In addition, the cash payment of \$1 billion for 2011-12 referred to in the policy announcements is not explicitly identified in the legislation, which does not provide certainty to industry;
2. Ensure there are no additional working capital requirements for liable entities from the operation of the *Clean Energy Bill 2011*, including from taxation and auctioning.
3. Provide longer term certainty to the sector by committing to ten years of rolling scheme caps followed by a ten-year rolling gateway. This is necessary to support the development of the emissions market in Australia and because global emissions prices do not provide sufficient long term information in isolation;
4. Cover the greatest proportion of greenhouse gas emissions possible. Measures that only target a subset of sectors of the Australian economy are unlikely to lead to least cost abatement; and
5. Ensure retail price regulation is removed for electricity and gas. Efficient prices are necessary to provide the appropriate signals for consumption and new investment and without full cost pass-through the viability of retailers and the entire electricity and gas supply industry is at risk.

#### 1. Adequate assistance to industry

##### *Energy Security Fund*

The Energy Security Fund provides around \$5.5 billion in nominal, pre-tax terms to affected generators over a six year period. Additionally, the Government may negotiate for the closure of around 2000 megawatts (MW) of highly emission-intensive (>1.2tCO<sub>2</sub>-e/MWh) coal fired generation capacity by 2020.

This sum does not adequately address the impairment of asset values across the electricity sector. It provides virtually nothing for the black coal fired generation

community – both state government and privately owned. esaa’s analysis suggests that just 8 or 9 out of the 31 baseload coal plants that provide the energy security the community takes for granted will receive assistance. Even fewer will be eligible for closure payments. This could only be rectified by increasing the quantum of assistance rather than reweighting the distribution of the existing assistance. The Association urges the Government to increase the quantum of the assistance and to broaden the eligibility criteria to address the impacts on existing investments and minimise the costs of future energy requirements.

Government modelling during the CPRS found that over the first 10 years black coal-fired generators would suffer asset value losses of \$5 billion to \$6 billion (real 2008-09 dollars). The latest Treasury modelling does not give the industry confidence that the outcome would be substantially different under the Clean Energy Future package. In fact, while the Treasury’s *Strong Growth, Low Pollution: Modelling a Carbon Price* report makes reference to SKM-MMA and ROAM Consulting’s results showing reduced profitability of coal-fired generators, the consultants’ reports themselves do not contain any of this information. The industry calls on the Government to release the details underpinning the estimates for the reduction in profitability of coal-fired generators as soon as possible. Figures presented for losses in profitability under the CPRS and CEF only cover the first ten years of the scheme, while the profitability of generators will continue to decline beyond this period as the carbon price increases and generators are prematurely retired.

Asset value losses will require government owners to inject further equity to their companies while for the private sector, in addition to the likely equity call, refinancing will be made very difficult as their commercial fundamentals are challenged. These issues are explored in detail in the Investment Reference Group report to the Minister for Resources and Energy.

As a last resort, the Government is offering loans for replacement debt and working capital to purchase future vintage permits, but at rates above the commercial market and subject to as yet undisclosed terms. The exposure draft legislation was silent on the provision of these financial facilities by Government, which raised concerns for industry. As such, the inclusion of the Government’s intention to provide these facilities in the legislation introduced to Parliament is a welcome indication of the Government’s commitment to provide these financial facilities. However, the detail of how these facilities will operate remains unclear.

Further, the industry does not support the upfront time restriction on these facilities – the bills limit loans for the purchase of future vintage permits to only during the first three years of future vintage permit auctioning, and loans for refinancing can only be made for three years from the commencement of the legislation. Given the major impact of the carbon price on the energy sector, and the fact that Australia has no experience with a major carbon market, the industry does not consider that the duration of these arrangements should be constrained in advance. Rather, the legislation should provide the flexibility for these facilities to be retained until market experience clearly demonstrates they are no longer warranted. One possible option is to include the loans as a matter to be examined as part of the first scheduled review of the Act by 2016.



Given the multi-billion dollar extent of impairment to assets from carbon pricing, transitional arrangements fail to fully address asset value loss and are certainly not the rent seeking and 'payment to polluters' that some would lead the community to believe they represent.

The Government has commissioned or requested multiple reports examining the impacts of emissions pricing on the energy sector. These have consistently warned of the potentially negative effects. The Energy Security Fund is not an adequate response to the material risks to the electricity market outlined in these reports.

The Chairman of the Australian Energy Market Commission (AEMC), John Pierce, advised the Government on 7 July 2011 in a letter addressed to the Hon Greg Combet AM MP and the Hon Martin Ferguson AM MP, that the carbon pricing package can be expected to result in "some but not all, of the generation businesses with high emission intensive plant to facing [sic] a degree of financial impairment that would place them under severe financial distress"<sup>1</sup>.

The Investment Reference Group (IRG) has also advocated for transitional assistance which preserved "sufficient net equity in the business to maintain its capacity to participate in the electricity contract market and undertake or contribute to the desired investment and reinvestment task"<sup>2</sup>. This issue of the impact of asset value impairment from carbon pricing on the electricity contract market has been raised by industry throughout the greenhouse debate and identified in a number of Government reports in addition to the IRG report recently.<sup>3</sup> However, the exposition of this issue has been qualitative to date. esaa has undertaken a modelling exercise to quantitatively examine the possible impacts of reduced contracting resulting from issues such as financial stress on generators, on wholesale, contract and retail prices. This modelling was commissioned from ACIL Tasman and was publicly released on 31 August 2011. It is attached to this submission. The findings of this study are discussed below in Section 2 on auction design and working capital burden.

In its advice to the Ministerial Council on Energy on the Garnaut Update, the AEMC argued that "granting permits in respect of specific plant would [allow plant owners] to maintain sufficient net equity in the generation businesses for them to be in a position to invest in the future"<sup>4</sup>. Reorienting five decades of investment in primarily coal-based generation to a lower emissions footing presents the Australian electricity industry with a massive investment task. The Treasury modelling estimates \$23-27 billion in generation investment is required by 2020 and more than \$200 billion to 2050. Other estimates put the investment challenge as high as \$220 billion to 2030, when networks are also included.<sup>5</sup> To achieve such a large

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<sup>1</sup> [http://www.ret.gov.au/energy/Documents/Energy-Security/energy-security-fund/AEMC\\_07\\_07\\_2011.pdf](http://www.ret.gov.au/energy/Documents/Energy-Security/energy-security-fund/AEMC_07_07_2011.pdf)

<sup>2</sup> Investment Reference Group, *A Report to the Commonwealth Minister for Resources and Energy*, April 2011

<sup>3</sup> See for instance, the AEMC Advice for MCE on Garnaut Paper, the Electricity Generation Investment Analysis report by Deloitte; the AEMC's advice to the Minister for Resources, Energy and Tourism and the Minister for Climate Change and Energy Efficiency.

<sup>4</sup> AEMC Advice for MCE on Garnaut Paper, 2 June 2011

<sup>5</sup> Australia's Energy Future, 4 May 2011, Speech to the Committee for the Economic Development of Australia.

investment task Australia will need to attract overseas debt and equity as well as domestic investment. It will have to do so under the context of a price on carbon.

Australia must consequently take steps to ensure it presents as an attractive destination if it is to raise this capital in the volumes required and at the lowest possible cost. In direct contrast to this imperative, diminishing equity investments through a disorderly transition will send a profound and damaging signal to the international investor community about Australia's sovereign risk and raise the risks of doing business in its energy sector. This will have consequences in less capital being available, and if it is, at higher debt/equity risk premiums, which will add to the cost of energy supplied to the community.<sup>6</sup>

The Government's policy announcement states that allocation of the cash payment under the Energy Security Fund is to be "based on the extent to which each generator's emissions intensity exceeds 0.86 tCO<sub>2</sub>-e/MWh 'as generated' multiplied by their historical energy output, calculated over the period 2008-09 and 2009-10".

However, the exposure draft of Part 8 of the *Clean Energy Bill 2011* did not refer to the \$1 billion cash payment to affected generators. To provide certainty and confidence to industry about this cash component and the way it will be allocated, esaa suggested in its 22 August submission that these matters be explicitly identified in the legislation. While the Association notes the added reference to "payments from the Energy Security Fund" in Section 163(2), this does not explicitly address the industry's concerns, especially given that "Energy Security Fund" is not defined in the bill.

In addition to explicitly identifying the \$1 billion size of the Fund, provision should be made in the bill that, should the \$1 billion not be allocated as currently proposed, an allocation of Australian carbon units of equivalent value will be made (including an adjustment for the time value of money). Such a provision would operate like the provision for default emissions caps, serving as a 'back stop' to decision-making processes outside of the legislation. While there is some detail in the Clean Energy Future policy documents, the legislation does not specify the arrangements under which the price for administratively allocated units sold back to the Government during the fixed price period will be determined. More generally, the absence of sufficient detail around Energy Security Fund terms means the legislation should either clarify these or defer liability until clarity is provided to enable companies to remain a 'going concern' under the Corporations Act.

The taxation treatment of this \$1 billion will result in a partial claw back through the taxation system of the ostensible value of the assistance publicised by the Government. The industry also notes that the proposed taxation arrangements for administratively allocated emissions units also results in the assistance being partially clawed back by Government through the tax system. This compounds the insufficiency of the assistance package to impaired generators and undermines the

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<sup>6</sup> As demonstrated by Simshauser & Nelson (2011) in their paper "*Carbon taxes, toxic debt and second-round effects of zero compensation: the power generation meltdown scenario*", it will be the Australian community that bears the costs of poorly conceived policies for the energy sector through higher equity risk premiums, which will add to the cost of energy supplied to the community.



stated purpose in the bill of administratively allocated units, which is to “help generators that face sizeable losses in the value of their assets and support investor confidence.” The industry therefore considers that as the imposition of a tax will reduce the level of compensation, it should be factored into the setting of the overall quantum of assistance.

### *Contracts for closure*

The concept of contract for closure is supported by esaa, but more information is required around how the mechanism will work, what effect it will have on any assistance already received by affected generators under Part 8 of the *Clean Energy Bill 2011* and what conditions applicants will have to comply with in order to receive assistance. However, the increased level of detail provided in Section 181 and 181A of the legislation, to clarify the interaction of contracts for closure with the Power System Reliability Test and Clean Energy Investment Plans is a welcome amendment to Part 8 of the legislation.

### *Energy Security Council*

The Government has proposed establishing an Energy Security Council (ESC) to advise it on systemic risks to energy security arising from the financial impairment of any market participants and measures to address these risks. Eligibility for assistance to address any systemic risks would be assessed on a case-by-case basis.

The NEM has not needed an ESC since its inception in 1998; competition and reliability of supply has thrived. The formation of an ESC suggests that the current policy settings are too harsh and not conducive to attaining a smooth transition.

The ESC and any initiatives it recommends would inevitably require extra bureaucratic structures and processes that amount to unwarranted interventions in an otherwise efficient market structure. They would also increase risk in the electricity market as the actions of the ESC simply add to the potential for undisciplined interventions by government. The directors of these businesses are obliged by law to respond to the known financial position at the time, and cannot rely on the uncertain responses of the ESC. Thus, as any measures deployed following the advice of the ESC are *ex post*, by the time any assistance is provided, the damage will already have been done. Fully recognising asset value impact and adjusting for it up-front would obviate the need for an additional, distortionary mechanism like the ESC. However, to the extent that an ESC is created, its mandate and activities should be clarified as soon as possible to provide information to the market. Further, given the commercial realities faced by businesses in the electricity market, the ESC should be designed so that it has the authority and operational capability to respond to any issues that arise within commercial timeframes.

## 2. Auction design and working capital burden

esaa has previously engaged closely with the Government on the need to design auctions appropriately. The industry considers that designing auctions with the needs of the energy sector in mind is reasonable as the stationary energy sector is likely to require a significant proportion of units sold at auction. The stationary energy sector’s

large share of the carbon units auctioned reflects: the restricted coverage of the carbon pricing mechanism (around 60 per cent of Australia's emissions); the large share of energy sector emissions in the covered sectors; and the fact that other covered sectors will receive significant administrative allocations through the Jobs and Competitiveness Program.

As carbon units will be a significant cost in energy production, the energy industry will need to secure prices for emission units before it can commit to sell electricity or gas – both in the current year and in future years under forward contracts.<sup>7</sup> This means that to support the energy contracting market the carbon pricing mechanism must enable liable entities to form, with reasonable confidence, a view of the price of emissions a number of years into the future. To achieve this, it is necessary to ensure that sufficient volumes are available in advance of each compliance year to support contracting.

In this context, the industry supports the provision in the legislation for auctioning of units for future vintages. However, it does not support the prescription in the legislation of a limit on the auction of future vintage units. The industry notes the Government's desire to retain flexibility in setting caps. However, the specified limit (which only comes into effect when there are no regulations in place setting the pollution cap) of 15 million units in the first six months of the year before the regulation is set and 15 million units a year in earlier years, is unnecessary. It is also low given the size of the energy sector's emissions (around 200 Mt per annum) and the established practice of contracting a number of years in advance. For instance, during the CPRS process the industry considered possible schedules of permit releases and arrived at a view that forward-auctioning around 50 per cent of each vintage would be necessary to support forward electricity contracting practices. It is suggested that the upfront restriction of 15 Mt be removed from the legislation, and the volumes of future vintages auctioned instead be determined in consultation with industry during the establishment of the policies, procedures and rules for auction carbon units.

As the industry has also communicated to the Government at great length, auctions should be designed to eliminate any increases in the working capital burden that a carbon price imposes on the energy sector. There are several measures which could alleviate this burden – such as deferred settlement arrangements – which have not been incorporated into the Clean Energy Future package.

As set out in the IRG report, generators will need to hold positions well in excess of \$10 billion – more than \$4 billion worth of units to comply with current year obligations, and positions on more than \$6 billion worth of units to support forward electricity contracting.<sup>8</sup> Unless there are appropriate settlement arrangements, the cost of holding these positions will significantly increase working capital requirements, exacerbate costs to meet prudential requirements and ultimately make

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<sup>7</sup> The forward electricity contracting market is an integral part of Australia's electricity market and is, among other things, an essential element in ensuring sufficient investment in new generation capacity to deliver reliable electricity supplies to consumers. Gas contracts are also managed in a similar manner.

<sup>8</sup> Investment Reference Group, *A Report to the Commonwealth Minister for Resources and Energy*, April 2011

prices for consumers higher than they need to be. Appropriate settlement arrangements are therefore essential to enable liable entities to manage working capital requirements, ensure participation at auctions and deliver liquidity to electricity contracting markets.

To minimise compliance costs it is necessary to devise auction arrangements that:

- allow liable entities to secure a price for their carbon units consistent with forward contracting practices;
- without requiring liable entities to settle on (or take receipt of) those carbon units until after they have received revenue for electricity sales;
- while being consistent with preserving the integrity of the carbon pricing mechanism.

The industry's preferred option to meet these objectives is delayed settlement arrangements. These arrangements would provide the option for the bidder and the auction authority to strike a contract to purchase at the outcome of the auction. Under this arrangement there would be no delivery of permit or settlement of funds at the time of auction. Rather, the receipt of the permit and settlement would be delayed until a specified later date when the participant has had an opportunity to earn revenues from the activity that gives rise to the emissions associated with that permit but before the due date for submission of carbon units for the relevant compliance year.

This arrangement would not increase working capital costs for businesses and hence it would relieve upward pressure on electricity prices. It would also support auction liquidity and hence encourage efficient price discovery as all parties with genuine intent to purchase and settle carbon units could participate, without capital constraints. However, as purchasers would not receive the carbon units until they paid for them, the contract-to-purchase would not be a provision of credit from the Government to industry; rather it would just allow the industry to cement its emissions costs to support its future contracting and manage cash flows. On this matter, we note that the Government's proposed loans to emissions-intensive generators to support future vintage unit purchases at auction will be priced at rates designed to encourage private sector finance. Far from reducing working capital costs, such a measure will add to them and ultimately increase prices for electricity consumers.

It is imperative the Government work with industry to develop arrangements which allow auction participants the option to receive and settle carbon units after they have had an opportunity to earn revenues associated with that permit. Further, as Australia has no experience with a major carbon market, the industry does not consider that the duration of this arrangement should be constrained in advance. This contrasts with the CPRS proposal to pre-emptively restrict the availability of delayed settlement for future vintage carbon units to only those sold between 1 January 2011 and 31 December 2013. Similarly, as noted above, esaa does not support constraining the period that the Government's loans for the purchase of future vintage permits are available in the legislation. Instead, the Association considers that they should be removed only once conditions clearly indicate they are no longer warranted. One

possible option is to include the loans as a matter to be examined as part of the first scheduled review of the Act by 2016.

If this principle were enshrined in legislation, many practical implementation issues would still need to be resolved. One such issue would be when permit receipt and settlement would occur. A few days before surrender date would be the simplest and most logical date for this; however, a more complicated schedule of settlements throughout the compliance year could be developed. For instance, the industry has previously discussed an arrangement under which the Government would receive the majority of cash from permit sales by the end of the relevant financial year. The industry is confident that the implementation of this principle could be subsequently developed through subordinate instruments as referred to in Part 4, Section 113 of the bill, drawing on the previous substantial work undertaken by the energy industry.

*Modelling the potential impacts on electricity prices of reduced contracting from poor auction design*

One of the potential impacts of requiring generators to pay for emission permits years in advance of when they are actually required is that it may limit participation in future vintage auctions. Given the need for generators to secure emissions prices in advance to support future electricity contracts, this could reduce the level of contracting in electricity markets, leading to adverse effects for consumers.

A number of recent government-related reports and advice have discussed the implications of reduced contracting on wholesale market stability and electricity prices for consumers in the context of carbon pricing.<sup>9</sup> As these reports discussed the issue from a qualitative perspective, following the release of the exposure draft legislation esaa commissioned ACIL Tasman to model quantitatively what could happen to electricity prices if contracting levels were reduced. The study is attached to this submission.

ACIL Tasman found that limiting the ability of generators to participate in future vintage auctions could reduce electricity contracting. Page 11 of the report states:

*Generators seeking to sell electricity contracts require the ability to manage the risk of input costs. For example a coal fired generator would be expected to contract for coal for extended periods. The coal contract may require the lodgement of some form of credit support covering say three to six months of supply, but the coal is normally paid for only once it is delivered.*

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<sup>9</sup> See for instance: AEMC, 7 July 2011, *Carbon Price Energy Security measures*, letter to The Hon Martin Ferguson AM MP and The Hon Greg Combet AM MP, p.3. , retrieved 18 August 2011 from [http://www.ret.gov.au/energy/Documents/Energy-Security/energy-security-fund/AEMC\\_07\\_07\\_2011.pdf](http://www.ret.gov.au/energy/Documents/Energy-Security/energy-security-fund/AEMC_07_07_2011.pdf); April 2011, *Investment Reference Group Report: A Report to the Commonwealth Minister for Resources and Energy*, pp.57-58, retrieved 18 August 2011 from <http://www.ret.gov.au/energy/Documents/Energy-Security/IRG-report.pdf>; AEMC, 2 June 2011, *Advice for MCE on Garnaut paper*, p.3., retrieved 18 August 2011 from <http://www.aemc.gov.au/News/Whats-New/AEMC-consideration-of-the-Garnaut-Update-Paper-of-29-March-2011.html>; Deloitte Touche Tohmatsu, 14 April 2011, *Electricity Generation Investment Analysis: Final Report*, p.45., retrieved on 18 August 2011 from <http://www.ret.gov.au/energy/Documents/Energy-Security/Deloitte-Draft-Report-on-Electricity-Investment-01.pdf>

*Carbon costs will be the single biggest input cost for coal fired generators (e.g. carbon costs at a price of \$25/carbon permit would be expected to **increase coal fired generation total operating costs by between 100% and 300%** [esaa's emphasis]).*

*On a similar basis to coal inputs, generators would also seek to contract for carbon for extended periods. However contracting in significant quantities through future vintage auctions would not be feasible because they do not have the financial resources to meet such large obligations so far into the future.*

*The inability to participate in future vintage auctions will limit the ability of generators to sell forward electricity contracts which will put downward pressure on electricity contract supply.*

The modelling indicated that with fewer future energy contracts being entered into, the likely result will be a more volatile and expensive electricity market and higher electricity prices for consumers. It shows that even a 5 per cent reduction in electricity contracting could result in at least a 10 per cent increase in retail prices in a single year for small users (households and small businesses) and up to a 15 per cent increase for large users. These rises in electricity prices are in addition to the carbon price.

The analysis shows that inappropriate settlement arrangements for permits that force permits to be paid for by generators before they are required – rather than in the year they actually emit the carbon - risks avoidable rises in electricity prices in addition to the carbon price. This risk could easily be avoided by appropriate settlement arrangements.

#### *Taxation arrangements for emissions units*

The industry notes that the Government will legislate to make supplies of permits GST-free. This is a welcome improvement on the CPRS position and is strongly supported by the industry as applying GST to normal permit transactions would have imposed an unnecessary working capital burden on businesses. However, the treatment of derivatives will follow their normal course of being subject to GST under the current rules, while the international carbon derivatives trading market will be GST-free (under the normal GST rules). The industry requests that consideration be given to extending the GST-free treatment to carbon derivatives in order to avoid disadvantaging the domestic carbon derivatives market.

However, esaa remains concerned with the proposed tax treatment under income tax law. In particular, the proposed taxation arrangements for the energy sector's units are inconsistent with the normal taxation and accrual accounting principle that expenses are recognised in the year they are incurred. This treatment leads to unnecessary working capital costs for the energy sector, much of which will already be under significant financial strain because transitional assistance is inadequate.

As set out in the *Clean Energy (Consequential Amendments) Bill 2011*, where a unit is purchased and surrendered in the same income year, a deduction will be allowed in that year.

However, if the unit is retained at the end of the financial year, the effect of the deduction will be deferred until the permit is surrendered or sold. Noting that the compliance date for surrendering units is 1 February in the following financial year, and that a business will not even know its liability until the finalisation of National Greenhouse and Energy Report requirements (which happens after the relevant financial year ends), it is likely that many businesses will retain units at the end of a financial year.

This means that the approach of tying the timing of the deduction to the date of surrender, and not to the year in which the emissions that give rise to the liability occur, can lead to a timing mismatch and is a deviation from normal taxation principles. It will impose an additional and unnecessary working capital burden on the energy industry because entities will have had a taxable uplift in revenue through the partial pass-through of permit costs into wholesale prices. The Association contends that deductions for the cost of permits should be allowed in the year that the obligation arises rather than in the year that permits are surrendered.

Furthermore, the industry does not support the Government's position that administratively allocated permits should be subject to tax. This will result in further cash flow implications for liable entities and will also potentially bias taxpayer decisions to acquit or sell rather than bank administratively allocated permits in order to avoid incurring an unfunded tax liability. This runs counter to the tax objectives of the scheme and could potentially introduce distortions to secondary markets if significant volumes of administratively allocated permits are sold.

esaa considers that the most appropriate tax treatment for administratively allocated units would be to allocate a nil value which would reflect their historical cost. They would be treated as assessable on receipt but would be allocated a nil value. A nil value deduction would correspondingly arise on use. While such a taxation treatment would not prevent the value of assistance to electricity generators from being further eroded (as generators would still pay additional tax on the partial uplift in electricity prices), it would at least remove the added working capital burdens.

If this approach is not considered acceptable by the Government, then an alternative model for the taxation of administratively allocated permits is that offered to emissions intensive trade exposed entities (EITEs) under the Jobs and Competitiveness program. EITEs will be subject to a 'no disadvantage rule' whereby administratively allocated permits held at the end of the initial income year are valued at zero to avoid the timing disadvantages described above.

### 3. Scheme caps and gateways

The Association has long argued that to provide investment certainty to the energy sector, emissions targets should be set out for as long as possible. In the case of the CPRS, this was to be done through a rolling five-year scheme cap, with up to ten years of 'gateways' to be renewed every five years. This was insufficient for the sector.

However, the position reached in the *Clean Energy Bill 2011* of a rolling five year scheme cap is a backwards step from the CPRS. Default pollution caps that will be in



place in the absence of Parliament passing scheme caps are not a substitute for well-defined caps and gateways.

It must be remembered that the carbon pricing mechanism involves, at heart, the creation of a market for emissions. In Australia's market-driven economy, the role of the emissions market is to drive emissions reduction by providing price signals to producers and users of emissions about their production, investment and consumption decisions.

Given the importance of the emissions market, it is important that the conditions are in place to support, as quickly as possible, the development of a well functioning emissions market. Importantly, the emissions market in a general sense will have numerous facets, including the primary market, secondary market, derivative markets, and the markets that interface between foreign and domestic emissions prices. To support liable entities managing their emissions obligations at least cost and with maximum flexibility, Australia would benefit from a liquid spot emissions market. To support investors to make large, long-lived investments with confidence, a clear forward price curve is necessary.

One of the conditions necessary to support a clear forward price curve is a forward cap. While the proposed rolling five-year cap is a start, it does not provide the long-term certainty that is required for investment. With energy asset lives well in excess of 40 years, the industry considers that as a minimum, annual emission caps should be set for a 10-year period that is extended by one year, each year. A further 10-year emissions gateway should also be provided to enable businesses to form a view of future carbon prices over a 20-year period.

One argument that has been put forward against longer caps is that the international forward price can act as a proxy for the forward Australian price. While international forward prices will provide important information bearing on the future Australian price, they will not provide sufficient information in isolation for a number of reasons. For instance, it is not yet clear which international units will be eligible to be imported into the Australian scheme. Only some CERs will be eligible to be imported, and presently it is unknown whether units from the EU or New Zealand can be imported. Further, the bill makes provision for the disallowance of international units in the future.

Secondly, there are numerous international units, so it is not possible to talk about a single "world price" of emissions. There is also ample opportunity for prices of international units to diverge. For instance, price divergence has been observed between units from the European Union's (EU) ETS with those created via the Clean Development Mechanism, known as CERs. Spreads between these prices has ranged from virtually zero to almost ten Euros per tonne over recent years.

Further, international unit prices will be driven by the policy choices of foreign governments and multilateral organisations that are difficult to anticipate and may be in response to country-specific factors, for instance, political decisions about the future use of nuclear energy.

While the Australian emissions markets will receive guidance from international prices for the Australian price, the market would be supported by a longer period of scheme caps and gateways.

#### *Limits on the import of carbon units*

The Association's position is that there should be no limits on the import of credible international abatement in order to minimise the cost to Australia of achieving emissions reduction goals. This is both economically and environmentally efficient as, in terms of what the atmosphere sees, it does not matter where abatement occurs. The industry is working through the full implications of the 50 per cent limit on imports. However, as a matter of principle and potentially of practice, the industry contends that the decision to restrict imports of international units to meet scheme liability will impede the flexibility of firms to manage their liability and is another threat that could result in the Australian price diverging from the international price. The decision of how to manage their liability should be left to businesses, rather than imposing an arbitrary cap on where abatement can come from.

#### 4. Scheme coverage

Changes in the coverage of the carbon pricing mechanism compared to the CPRS are of concern to the energy industry. A comprehensive ETS covering emissions from as much of the economy as possible leads to a more efficient outcome with abatement coming from the lowest cost sources. The CPRS covered all six greenhouse gases and around 75 per cent of total Australian emissions. However, the Government's proposed carbon pricing package has gone backwards from this position. Only four greenhouse gases will be covered under the carbon pricing mechanism, with the transport and agricultural sectors – the second and third largest sources of greenhouse gas emissions in Australia – excluded from the proposed emissions trading scheme. While some proposed complementary measures may assist, reduced coverage still results in sectors covered by the carbon price and ETS facing greater restrictions than they would otherwise.

The industry's preliminary analysis suggests that the energy sector will be required to surrender around 60 per cent of available units. This forces the sector to do the heavy lifting for the economy, despite inadequate compensation, working capital burdens, insufficient information about scheme caps and gateways to drive investment, and the potential inability to pass-through costs to retail tariffs in some states.

The decision to exclude certain sectors of the economy also results in a lower scheme cap, with fewer domestic units on issue. A smaller emissions market is likely to have less liquidity and be less conducive to the development of a well-functioning and efficient secondary and derivative market. Additionally, should a lack of abatement from uncovered sectors result in a tightening of the scheme cap in order to meet Australia's emissions reduction targets, this will lead to covered sectors being required to do more of the 'heavy-lifting' in order to meet the emissions target. This will produce sub-optimal results, with a higher carbon price than necessary translating into higher costs for households and businesses.

The new opt-in scheme for large fuel users who would prefer to manage their liability through purchasing permits rather than being subject to changes in the fuel tax credits regime is a welcome amendment to the legislation. esaa notes that the design of this scheme will be established in regulations.

If designed appropriately, the opt-in scheme could lead to a higher scheme cap than otherwise would have been the case, with more participants demanding permits and potentially more liquidity in emissions markets. Such a change would, in esaa's view, be of benefit to the scheme overall. Nevertheless it is not a substitute for having a scheme architecture that captures as many sources of emissions as possible.

## 5. Retail price deregulation

An intentional part of pricing emissions in Australia is to allow the price of carbon-intensive electricity to encourage changes in behaviour. The Treasury modelling projects wholesale prices increasing by 40 per cent compared to no carbon price to 2020 and by 100 per cent by 2050. The electricity price consequences of a price on carbon must be addressed constructively.

For a carbon pricing mechanism to operate efficiently and provide least-cost emission reductions, consumers should be exposed to the cost implications of greenhouse gas emissions. Providing efficient price signals to consumers will enable the carbon price to drive abatement on both the demand and the supply side of the energy market. This is demonstrated in the Treasury modelling, which finds that reduced demand from carbon pricing delivers almost half the cumulative abatement to 2020 from the electricity sector.<sup>10</sup> While not reported in the Treasury modelling, a similar type of effect could be expected from the pass-through of emissions cost into gas prices.

esaa considers that the best way to pass through emissions costs and provide end-use customers with appropriate signals to consume efficiently and engage in cost-effective energy efficiency and demand-side management activity is to let retail prices be set by open and competitive retail markets.

In contrast, the retention of regulated price caps creates the real risk that retailers may be prevented from passing on in a timely manner higher wholesale energy and network related costs, as well as increased prudential costs associated with the carbon price. This could force significant losses for retailers and make them unable to contract forward with generators. Systemic failure or financial distress among major retailers would increase volatility and risks in the energy market, reduce competition and potentially undermine system reliability and security of supply.<sup>11</sup>

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<sup>10</sup> This result is driven by an assumption that in the medium term, a 10 per cent increase in wholesale electricity prices leads to a 3 per cent decrease in electricity demand across the economy.

<sup>11</sup> The issues with retail price regulation under emissions pricing are examined in work by Farrier Swier Consulting, commissioned by the Energy Retailers Association of Australia in 2009. While this was in the context of the CPRS, which had a different scheme design to the current carbon pricing mechanism, the general points are salient. The report found that to maintain a financially viable and competitive retail sector, retail prices must reflect costs and that there must be flexibility to adjust retail prices quickly. Given that such adjustments are at

Previous commitments from the Government to work with the states, through processes such as the Ministerial Council on Energy (MCE) and the Council of Australian Governments, to move towards retail price deregulation have failed. Only Victoria has de-regulated electricity prices; all other jurisdictions have maintained price control over electricity for small-use customers. Since the release of the exposure draft legislation, the Australian Capital Territory Government has announced that it will ignore the recommendations of the Australian Energy Market Commission to remove price regulation following a detailed review. With respect to gas regulation, while there has been more progress, three jurisdictions still retain price regulation over small use customers. A recent decision by the Western Australian government to overrule the recommendation of its own regulatory agency to allow a 30 per cent increase in tariffs and allow a privately-owned gas retailer only a 10 per cent increase is a worrying case in point.

The Government is compensating the vast majority of households for the assumed cost impact of the carbon price, with millions being compensated to the point where they will be better off compared to their average impact (which it should be noted was based on Treasury's assumption of full pass-through). In this context, where jurisdictions refuse to commit to retail price control reform, the Commonwealth should ensure that financial penalties are applied. Financial penalties have proven effective in eliciting difficult but necessary energy market reforms in the past.<sup>12</sup>

However, where retail price regulation remains in place there should, at the very least, be a consistent, national framework for the regulation of both electricity and gas retail prices that enables cost-reflective pricing and the full pass-through of emissions-related costs to consumers.

### **Drafting issues**

The following section provides commentary on key drafting concerns that the Association has identified in the legislation, noting the very limited time provided for consultation.

To support this, Attachment A provides clause-by-clause detail on the issues raised below, as well as other items identified by the industry.

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odds with current retail price regulation governments need to act to remove or change retail price regulation. The report is available here:

[http://www.eraa.com.au/db uploads/Farrier Swier Carbon Pass Through Report Final.pdf](http://www.eraa.com.au/db/uploads/Farrier_Swier_Carbon_Pass_Through_Report_Final.pdf)

<sup>12</sup> In its 2003 National Competition Policy assessment, the National Competition Council recommended a suspension of 25 per cent of Queensland's competition payments (10 per cent pending implementation of contestability for tranche 4A customers and 15 per cent pending the outcome of the wider review of full retail contestability). In February 2004, the Queensland Government announced the extension of retail competition to tranche 4A customers, which commenced on 1 July 2004. However, by the time of the 2004 assessment, Queensland had still not reviewed the costs and benefits of full retail contestability in accord with its 2003 commitment. The Council therefore recommended that the 15 per cent suspension of 2003-04 competition payments be deducted permanently; it also recommended a new suspension of 15 per cent of 2004-05 competition payments, pending Queensland's completion of the review of full retail contestability and implementation of its findings. The Australian Government accepted this recommendation. On 28 September 2005, the Queensland Premier announced that full retail contestability would be introduced for small businesses and households from 1 July 2007.

esaa notes that there is substantial detail still to be provided in regulations. Any subordinate legislation relevant to the sector should be released at the earliest opportunity, and provide for a meaningful consultation period.

### Carbon Pollution Cap

The default cap proposed in s18 of the *Clean Energy Bill 2011*, while being an attempt to provide certainty on emission caps in the absence of a Regulation being made, could be improved considerably. As currently drafted, the default caps deliver an outcome that appears inconsistent with the overarching reduction goal, and provide limited guidance for anticipating the likely caps set by regulation.

Analysis by esaa suggests that the 12 million tonne reduction from the previous year's cap (as per s18 of the bill) potentially results in the scheme cap reaching zero by around 2040. This would require an unlikely set of circumstances to eventuate, but even disregarding this, the 12 million tonne default represents an increasing proportion of a declining scheme cap. Effectively this results in the covered sectors of the carbon pricing mechanism being required to provide a disproportionate amount of abatement for the Australian economy in the event the default cap is activated.

The industry considers there is a more appropriate approach to s18, whereby the prospect of the scheme cap ever reaching zero is prevented. Possible approaches would be to specify a percentage reduction from the previous year's scheme cap; alternatively it could be the lesser of 12 million or a preset percentage reduction.

Default caps should represent a reduction pathway that is consistent with the overarching target set in s3, as well as Australia's 2020 target, rather than a punitive measure taken out against businesses should Parliament be unable to agree on a cap.

Noting earlier comments regarding the shortened window of information on scheme caps and gateways, s18 could also be amended to provide that default caps are in effect an "upper-bound" for any regulations setting scheme caps. Such an approach would provide considerable benefit to the market. It would serve as a useful guide, providing certainty that any cap set by regulation will be lower than the default cap. In this case, the default cap would probably require redesigning from its existing 12 million unit reduction to be appropriate.

### *Regulations for setting carbon pollution caps*

The Minister is required to set the first five years of scheme caps no later than 31 May 2014, according to s16. In the interest of providing information to scheme participants, esaa considers that these regulations should be released as soon as possible.

Section 14 outlines the items to which the Minister may have regard in setting carbon pollution caps. It is considered that these items are altogether too vague in some instances. The industry recommends that subsection 2c(v) be split and amended to read "the cost to the Australian economy of meeting various levels of carbon pollution caps" and "the social implications associated with various levels of carbon pollution caps."

Similarly, subsection 2c should also make explicit mention of the actions of Australia's key competitors. While this section does refer to the Minister having regard to "global action to reduce greenhouse gas emissions," it is considered that there should be a specific reference to key economies. The industry's proposed addition is that the Minister may have regard to "the actions taken by key economies to reduce greenhouse gas emissions."

### Liability entities

The definition of liability as a person who has operational control is a welcome improvement from the CPRS. Operational control is a definition that has been applied for a number of years now under NGERs and increases the likelihood of a holder of a contract to supply triggering a change of law clause to adjust prices for emissions costs.

### *Gas issues*

esaa notes the change from the exposure draft's default point of liability from the natural gas retailer to the natural gas supplier. The Association raised concerns that "natural gas retailer" was to be defined in regulations. This has now been changed to put liability on the natural gas supplier which is defined as "a person who supplies natural gas". The intent of the exposure draft provisions was understood by esaa to place the point of liability under s33 on downstream natural gas retailers, but that as originally drafted there was a risk that upstream entities in the natural gas supply chain may have been captured if there was not a clear definition of natural gas retailer.

This change, along with the introduction of the concept of a large gas consuming facility in section 55A, seems to address these concerns. Large gas consuming facilities are defined as facilities whose covered emissions from natural gas combustion are equivalent to more than 25,000t CO<sub>2</sub>-e or another amount specified in regulations. These facilities must quote an OTN to their supplier of natural gas. Once a facility is designated a large gas consuming facility it will remain so until it passes conditions set out in regulations. These conditions will be designed so that facilities that have reduced their natural gas combustion emissions consistently to below 25,000t CO<sub>2</sub>-e will no longer be a large gas consuming facility.

It is commendable that the Government has taken these concerns into account and sought to improve the design of the liability mechanism for the natural gas industry.

The industry also considered that s34 of the exposure draft legislation created unintended and inefficient outcomes for some non-retail gas consumers, such as small transmission pipelines and other non-retail natural gas users. Section 34 established that for the natural gas industry, all facilities will be captured as liability entities regardless of the amount of emissions produced. esaa notes that Section 34 of the exposure draft legislation has been deleted.

Finally, in section 51 it is noted that in circumstances where a person has ceased to be an eligible holder of an Obligation Transfer Number (OTN), the person has no obligation to notify their gas supplier. esaa argued that in the interests of satisfactory



scheme coverage and minimising disputes, that such a person be obligated to notify their supplier. It is noted that with the addition of section 43A, the Regulator is required to publish a list of OTNs that have been cancelled or surrendered and the date on which this took effect. This amendment will have a similar effect to the amendments proposed by the Association on the exposure draft legislation and esaa welcomes its inclusion.

### *Joint ventures and partnerships*

The new approach to apportioning point of liability for unincorporated joint ventures (JV) when compared to the CPRS is supported by the Association as it allows application of a liability to align with existing commercial practices. It is considered that similar treatment needs to be afforded to partnerships, on which the legislation is currently silent. Alternatively, another potential solution for the treatment of partnerships is for partnerships to be treated as a “person” as defined in the bill.

In its submission on the exposure draft legislation, esaa argued that there was an apparent inflexibility for the point of liability in circumstances where one of the joint venturers is also the operator of the facility, whereby there was no potential to transfer or apportion across the joint venturers. The Association considers that the changes made to Section 67 in the legislation appear to resolve this. esaa also notes the removal of the provision which prevented JVs passing the JV declaration test if they included a foreign person.

### Coal-fired electricity generation

Part 8 explicitly restricts the allocation of transitional assistance where a generation complex enters into a contract for closure with the Government. The Government’s policy announcement states that “generators contracting with the Government to close will be required to forego their administrative allocations (and will not have to comply with associated conditions) but will receive value equal to the foregone assistance plus an additional payment for closure”.

While it is understood that payment for closure will be dealt with outside of the legislation, esaa argued that the exposure draft *Clean Energy Bill 2011* was unclear as to how the administrative allocation of units (and cash payment) calculations for all generation complexes will be impacted by generation complexes claiming both forms of assistance. The amendments to Section 181 and 181A appear to address these concerns.

In its submission on the exposure draft legislation esaa argued that under Section 162 *Application for certificate of eligibility for coal-fired generation assistance*, there was a timing issue with regards to issuing certificates of eligibility for coal-fired electricity generation assistance. Under the exposure draft, the issuance of a certificate of eligibility, which is required in order to receive assistance, might not be granted until after the end of the 2011-12 financial year, when the first tranche of assistance is due to be received.

The changes made to the legislation now give generators 30 days from the commencement of the legislation (with an additional 30 day extension at the

Regulator's discretion available) to lodge an application. The Regulator now has up to 150 days from the commencement of the bill to approve the application compared with 300 days in the exposure draft legislation. These amendments should allow these certificates to be granted before the end of the 2011-12 financial year, which is a welcome improvement to the legislation. However, we note that the timeframe generators have to put their applications together, including third party verification and supporting documentation, is tight.

There is also interest in how the Government's buy-back of unused carbon units issued under Part 8 of the bill will operate. In its submission on the exposure draft legislation, esaa called for there to be consultation on the regulations specifying the discount factor which is to be applied for the buy-back. The Association notes the release of draft regulations about the discount factor (along with other issues) on 21 September.

### *Power System Reliability Test*

It is noted that the Power System Reliability Test conditions, as drafted, enable entities to meet the test requirements in three ways:

1. The registered nameplate capacity of the generation complex is maintained over time (the status quo approach), or
2. The registered nameplate capacity of the generation complex is reduced over time, but AEMO or IMOWA certifies that there is unlikely to be a breach of the relevant power system reliability standards within two years (the certification approach), or
3. The registered nameplate capacity of the generation complex is reduced, but the person that is registered as a generator for that generation complex also constructs new replacement capacity that complies with the relevant requirements set out in the bill and regulations (the Low Emissions Transition Incentive).

esaa notes the alternative approaches that generators receiving assistance under the Energy Security Fund have available to them to meet the Power System Reliability Test requirements, however, the industry has identified a number of operational issues and details that require further consideration and clarification.

Firstly, it is noted that esaa's original concerns that the exposure draft's definition of what constitutes a generation complex's "nameplate rating" was unsuitably vague, have been considered. The definition of "nameplate rating" is now more explicitly defined in the bill. This change is a positive step towards improving issues relating to the Power System Reliability Test.<sup>13</sup>

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<sup>13</sup> However, we note that there could still be some uncertainty in its application, given potential differences between maximum generation figure applicable to a generator's performance standards which is registered with AEMO (Generating unit Rated MW) and the maximum generating capacity in MW as published by AEMO on its website (that sets the upper boundary to which generating units can be bid). As such, if and when the Power

As drafted, the bill is unclear in defining the decision-making criteria that will be applied by AEMO and IMOWA in determining whether a reduction in a generator's nameplate rating will impact system reliability standards. The decision making process used in determining whether certification will be provided to a generator seeking to reduce its registered nameplate rating should be clarified in the accompanying regulations.

Additionally, it appears that the Test results in an 'all or nothing' approach to assistance whereby a small impact on power system reliability, or a slight delay in the submission of a Clean Energy Investment Plan (CEIP) results in the total removal of assistance to generators. This results in disproportionately strong consequences. More discretion is needed so that any reduction in assistance is reflective of the magnitude of the threat to power system reliability or delay in submission of a CEIP, and this principle should be captured in the legislation.

An important feature of the CPRS low emission transition incentive, which applied to replacement capacity under the Power System Reliability Test, was the flexibility provided for market participants. In effect, the operator of an eligible coal-fired generator could withdraw capacity and commercially negotiate for another party to nominate their new capacity as replacement. There are two key benefits of such flexibility. Firstly, it does not bind an incumbent market participant to reinvesting in new low emission capacity and secondly, this flexibility would likely encourage the earlier entry of new lower-emission capacity. esaa considers the current drafting is not clear on whether such flexibility has been retained, and recommends clarity in the provision is provided. Further flexibility could be provided by removing the specific requirement for the replacement to be in the "same region".

It is also unclear how AEMO and IMOWA would handle multiple requests for assessment of reliability standards from generators in the event that more than one generator was seeking to reduce their nameplate rating. Questions arising include:

- Would it be on a first come first served basis?
- Would it be based on the relative emission intensity of the generation complexes seeking a review?
- Would it be based on the net emission reduction of alternative closure options?
- Would the timing of certification for multiple generators be modified to accommodate the requirements of all?

esaa requests that its members be consulted on the design elements of the power system reliability test to ensure that outcomes for the electricity market, and recipients of assistance under the Energy Security Fund, are consistent with the objectives of the *Clean Energy Bill 2011*.

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System Reliability test is applied, we encourage AEMO to consult with industry to ensure the most appropriate figure is used.

The industry supports the improvements made to the Power System Reliability Test compared to the CPRS, including inserting a timeframe for the market operator to make a statement and clarity that no statement is taken to be the passing of the test.

### *Clean Energy Investment Plans*

The bill requires that generators receiving assistance under the Energy Security Fund must develop and submit a CEIP to the Minister for Resources and Energy for publication on an annual basis.

The requirement for CEIPs to be published as required by s180 risks commercially sensitive information being disclosed. While the desire for public scrutiny is understandable, there is a risk that the publication of these plans could compromise leadership in innovation.

esaa criticised the lack of detail in the exposure draft legislation on what was required as part of a CEIP. The amendments to Section 178 of the bill now provide greater clarity for affected generators, which is a welcome amendment.

### Auction Design

The details surrounding auction design will be critical for the industry. The absence of auction design detail from the draft legislation allows the Government the opportunity to work with and consult actively with industry in designing the legislative instrument to implement auction design arrangements. The industry looks forward to engaging with the Government to discuss draft auction design details as soon as possible. It will be essential that there is adequate time for industry to consult with Government on these arrangements.

The industry noted that the drafting of the exposure draft legislation (see section 111(5)) would result in the auction needing to be run on a “pay-as-bid” basis, rather than a common clearing price. The industry considers the latter to be more appropriate (and was the proposed mechanism under the CPRS), but also suggests that this matter need not be specified in the legislation. It appears that the addition of Section 111(6) is an attempt to rectify this; however, it is not clear that the drafting of 111(6) addresses esaa’s concerns and therefore further clarity in the bill is required.

### International Unit Surrender Charge

The *Clean Energy (International Unit Surrender Charge) Bill 2011* explains the circumstances under which a charge will be levied on the surrender of international units. As esaa understands it, the purpose of the International Unit Surrender Charge is to ensure that the price floor that is in operation from 1 July 2015 to 30 June 2018 for domestic units would also effectively apply to international units in years when the international price may be below the Australian floor price. The charge would therefore act as a ‘top-up’ fee. Nonetheless, much of this detail is to be contained in regulations and as a result the interaction between the floor price and international units is not clear.

The Association considers that lower-cost abatement would be better achieved without this charge artificially increasing the marginal cost of overseas abatement.

The charge is likely to present a number of practical issues. It seems overly burdensome to implement and unnecessary to maintain the scheme's integrity. It also serves to discourage forward contracting of international units.

The charge could potentially discourage Australian businesses from engaging in primary Clean Development Mechanism (CDM) projects, which typically have a lower price than CERs traded on the secondary market. This is because primary CDM projects entail a greater degree of risk for participants. By imposing a charge on top of this price, it is unlikely that businesses would be prepared to take on this risk, when any potential reward is being taken away by the surrender charge.

The legislation states that the charge in each year will be set in regulations. At this stage there is no available information on how and at what point in a compliance year this charge will be set. The timing of setting the charge (if applicable) will affect the relative risk of purchasing international units early or late in a compliance year. The manner in which the benchmark international price for that year will be determined is also unknown.

Almost all mechanisms to implement the price floor will be inaccurate and too broadly targeted to achieve the overall aim. For example, there is a distinct possibility that there could be one rate for all scheme participants, irrespective of the price that a participant may have actually paid for the international unit. This creates significant risk and uncertainty for scheme participants who may purchase international units in advance of compliance years. For example, a scheme participant who purchases an eligible international unit at A\$20 in 2015-16 may be charged for surrendering this unit in later compliance years if the international price subsequently falls and a surrender charge is set in regulations. This would result in a perverse outcome for scheme participants looking to manage their forward compliance risk.

Suppose also that a charge was imposed day by day based on the spot price for international units. Not only would this be difficult to implement due to the variety of international units, it would also discourage forward contracting as the price in the spot market would be used to determine the charge regardless of the price actually paid by participants.

If the Government insists on maintaining the international unit surrender charge then the Association proposes that a self-assessment model, similar to the tax system, is one possible option that could be explored. This could involve businesses which surrender international units reporting the overall price paid for international units with a true-up of any difference between the price paid and the floor price. Alternatively, publication of the future surrender charges by 1 July 2012 would assist the market and allow informed decisions to be made on contracting international units during the period when the charge applies.

#### Surrender of eligible emissions units

There is concern over the way in which the Government may disallow the use of certain international units. The industry agrees that it is very important to maintain the environmental integrity of the scheme, and allowing the continued use of flawed international units could compromise this integrity. However, the proposal to prohibit the use of specified international units as of the next financial year is overly strict.

Section 123 of the *Clean Energy Bill 2011* provides for the prohibition of the surrender of specified international emissions units. Section 4.84 of the *Commentary on the Clean Energy Bill 2011* goes on to explain that liable entities holding such units in their Registry accounts will be able to use those units for compliance in the compliance year in which the unit was disallowed, but not subsequently.

The provision that regulations prohibiting the surrender of specified eligible international units take effect from the following year after the regulations are registered is not supported. This does not provide sufficient notice to businesses of a change of law and is an inappropriate allocation of risk. Furthermore, it discourages the development of international emissions markets as it creates risks for businesses in establishing contractual arrangements for supplies of international units. While noting the need to ensure the environmental integrity of the scheme, it is suggested that there be no retrospective application of any changes in eligible international units (noting that the Government has the option of purchasing additional abatement to redress any environmental concerns). Alternatively compensation could be paid to the holders of prohibited international units negatively affected by the change of eligibility.

A transitional period of time is not without parallel elsewhere in the *Clean Energy Bill 2011*, as Section 157 states that “changes that will have a negative effect” should not take effect before “the end of the 3-year period that began when the change was announced.” A similar timeframe should therefore apply to liable entities holding such units in their Registry accounts.

#### Information-gathering powers and monitoring powers

The Association opposes the powers vested in the Regulator with respect to information gathering (Part 13) in that the Regulator may require disclosure for very broad reasons, such as seeking information relevant to the operation of the Act or substantiating information.

esaa considers that powers conferred under Part 13 should be contained to only those circumstances where the Regulator has a reasonable belief that breach or non-compliance has occurred or for the direct purposes of assessing compliance.

In addition, the monitoring powers conferred under Part 15 should be contained to only those circumstances where a breach or non-compliance has occurred or for the direct purposes of assessing compliance.

Further, the requirement for compliance s.221(4) should be qualified as reasonably capable, in that business capability to respond to the Regulator may be present but detrimental to other operations. This qualification would balance the extensive nature of the following provisions of s.221(5).

#### Unit shortfall charge

The shortfall charge of 130% of the carbon price in a fixed price year, and 200% of the benchmark average auction charge in other years, results in an additional penalty given that it is not tax deductible. This is a severe penalty for an offence which may have been the result of an entity’s annual emissions being revised after the surrender



date for a financial year. This would result in an entity paying a shortfall charge despite having acted in good faith in reporting emissions, which were then revised upwards.

esaa argues that the unit shortfall charge should be reduced from its level of 200% of the benchmark average auction charge in a flexible charge year. At a minimum, however, the unit shortfall penalty should be tax-deductible. This approach maintains a strong penalty for non-compliance, while not being excessively onerous.

There has, however, been a worthwhile improvement to unit shortfall charge arrangements. esaa notes the introduction of a provision at Section 134A that states that if participants voluntarily disclose this shortfall, the Regulator may remit the unit shortfall charge. While there are conditions attached to this voluntary disclosure, such as the Regulator's view of whether the person took reasonable precautions and exercised due diligence to avoid the incorrect number being specified in the first instance, this is a positive amendment to the legislation.

## Taxation

### *First-in-first-out (FIFO) Rule*

The Industry did not support the application of a FIFO treatment for emissions units of the same vintage where the cost method is applied, as proposed in the CPRS Exposure Draft legislation. The Association therefore welcomes the Government's decision to allow businesses to choose whether or not to use the FIFO method when accounting for the value of permits.

### *Valuation Methodology*

Under item 420-55, tax payers are able to value all units held at the end of an income year at cost, using the (FIFO) cost method, the actual cost method, or at market value. Tax payers will have the choice of changing valuation methodologies once until 2014-15. From then on, tax payers will be able to change their valuation methodology after they have used a methodology for at least the four previous years that units were held at the end of the income year. This is a notable improvement from the CPRS when tax payers were only able to change valuation methodologies once during a transitional period, before that valuation methodology was locked in.

### *Deductions under Division 420*

Item 420-15(2) allows deductions for expenditure incurred in becoming the holder of an emissions unit but only in the income year in which you start to hold the permit. It would be simpler to allow eligible expenditure to be deducted as incurred.

Item 420-15(3)(b) indicates that deductions cannot be claimed for expenditure incurred in becoming the holder of an emissions unit issued in accordance with Part 8 (coal-fired electricity generation) of the Act. The industry understands this provision was intended to keep such expenditure out of the rolling balance but not deny deductions under other provisions. A clarifying note to this effect should be included in the legislation.

### *Same Business Test*

The industry requests confirmation from the Government that trading in permits does not constitute the undertaking of a new business for the purposes of the Same Business Test.

### *Stamp duty*

The industry notes that generally stamp duties are outside of the federal government's jurisdiction. However, under cl.B4 of the Intergovernmental Agreement on Federal Financial Relations which operates from 1 January 2009, State and Territory Governments agreed not to levy stamp duties on the transfer of emission trading permits after 1 July 2013. esaa encourages the Government to ensure that States maintain this agreement in order to provide certainty to industry.

### Governance arrangements

The Clean Energy Future package outlines the Government's intent to establish several new agencies to oversee the carbon pricing mechanism and to assist in the transition to a low emissions economy. These include the Climate Change Authority, the Clean Energy Regulator, the Clean Energy Finance Corporation and the Energy Security Council. Whilst the roles of the Authority and the Regulator are spelled out in regulation, there is no mention of either the Energy Security Council or the CEFC.

### *Energy Security Council*

The Clean Energy Future legislative package provides no details as to the make-up or role of the Energy Security Council. It is important for the industry to have clarity over the arrangements supporting the establishment of this Council, given the proposed role of it as stated in the Clean Energy Future policy documents. esaa calls on the Government to release details in legislation or regulations as soon as possible, and to provide for consultation with industry.

### *Clean Energy Finance Corporation (CEFC)*

This body could have a valuable role to play in helping emergent technologies to overcome barriers caused by financial market failures in the low-emissions generation sector. However, it must be recognised that there is already a scheme, the Renewable Energy Target, which is the primary mechanism for facilitating the deployment of renewable energy in Australia and should remain so.

Nevertheless, to the extent that there are market failures that arise from factors such as a limited understanding of newer technologies, an overestimation of the risks associated with a particular type of plant or a preference in the market for short-term over long-term returns, then there will be scope for the CEFC to fund projects that are unable to secure private funding on reasonable terms.

However, there is a risk that providing finance on a concessional basis could result in the Government – regardless of the independence of the Corporation – crowding out private finance. Additionally, where concessional finance is provided to firms wishing to participate in competitive dispatch markets such as the NEM or WEM, this could

result in a subsidy to new participants at the expense of existing generators. This distortion would come against the backdrop of fundamental shifts in generation that will take place under a carbon price, and could undermine the prospects for privately financed low-emissions generation.

The industry considers that further detail is required to understand the impact of the CEFC on electricity markets.

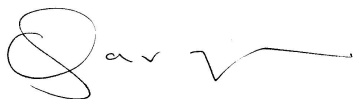
### Conclusion

For Australia to continue to enjoy a reliable, competitive electricity supply while also reducing its greenhouse gas emissions as a society, it must be very careful in its policy choices.

The industry calls for a well-designed emissions trading scheme which strikes a balance between introducing incentives to transition the sector towards lower emissions generation and maintaining an orderly transition. Any carbon pricing mechanism must deliver abatement; provide clear and timely signals for new investment; and manage the transition for emission intensive plant and address impairment of legacy assets to ensure reliability and security of electricity supply. Anything short of this would constitute policy failure. Given how deeply embedded the energy industry is into modern Australia, every Australian household and business has a stake in getting it right.

Any questions about our submission should be addressed to Kieran Donoghue, by email to [kieran.donoghue@esaa.com.au](mailto:kieran.donoghue@esaa.com.au) or by telephone on (03) 9670 0188.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Clare Savage', with a stylized flourish at the end.

**Clare Savage**  
Interim Chief Executive Officer

**Energy Supply Association of Australia**  
**Detailed comments on Clean Energy Future exposure draft legislative package**  
**September 2011**

Clean Energy Bill 2011			
Part/s	Division/s	Section/s	Comment
1		3	It is considered that the objects do not adequately identify the mechanism being introduced or the key commitments of assistance to industry. esaa notes that an addition to the objects has been made which states that the object of the bill is “to put a price on greenhouse gas emissions...” in line with the Association’s proposal that the objects should specifically include imposing a cost on emissions. esaa considers that this could be further strengthened by adding that the cost is to be borne by consumers in order to send the appropriate price signal and thereby drive behavioural change.
1		3(c)(ii)	A key object of the Act is to take action towards meeting various targets in “a flexible and cost-effective way”. This umbrella statement is not defined in the Act but should be an important consideration in reviewing the performance and achievements of the Clean Energy Act. It is recommended that this statement be defined and reflected in Part 22 – Reviews by the Climate Change Authority.
1		6	In commentary on the exposure draft esaa discussed the implications of leaving the definition of natural gas retailer to regulations. The Association notes the change to a point of liability for natural gas emissions based on the natural gas supplier.
2		14(2)	Regarding matters the Minister may have regard to in recommending regulations on the carbon pollution cap, it is suggested that the drafting make clear that items (c)(iii) and (v) refer to: <ul style="list-style-type: none"> <li>– The extent of global action to reduce greenhouse gas emissions, including actions taken by key trading partners.</li> <li>– The cost to the Australian economy and the impact on the energy sector associated with various levels of carbon pollution caps</li> </ul>

Clean Energy Bill 2011			
Part/s	Division/s	Section/s	Comment
2		16(1)	<p>The approach the bill takes to setting scheme caps by May 2014, nearly two years after the scheme starts, gives insufficient notice as to the cap that will be in place. Given the long lead times in the energy sector and businesses' need to plan their investments under carbon pricing, it is important that the initial scheme caps be known as soon as possible (either as set out in regulations that are not disallowed or via any default trajectory). Ideally, the scheme caps should be set no later than 31 May 2012.</p> <p>The proposed scheme cap tenure of five years is not supported. The scheme cap should have a tenure of 10 years to provide adequate certainty for investment in capital-intensive infrastructure. In addition, a 10-year rolling gateway similar to that proposed under the Carbon Pollution Reduction Scheme (but extended by one year every year, unlike the CPRS approach, which allowed the gateway to contract to five years) should also be included.</p>
2		17, 18	<p>The provision for the default scheme cap for 2015-16 is a reduction in emissions of 38 million units compared to emissions from liable entities for 2012-13. For each subsequent year the default is in place, the emissions cap is reduced by a fixed amount of 12 million units each year. This approach is not flexible enough and could lead to perverse outcomes.</p> <p>Firstly, if the default were in place continuously, it would lead to a scheme cap of zero by around 2040. While this is an unlikely outcome, of additional concern is that the preset reduction of 12 million units will become an increasingly proportional reduction of a (presumably) decreasing scheme cap. For instance, if the default is in place in 2016-17 it would represent approximately a four per cent reduction (assuming the scheme cap is around 300 Mt in 2015-16). Over time, if the scheme cap is tightened to 200 Mt, for instance, a 12 Mt reduction is a six per cent reduction.</p> <p>An alternative, more balanced approach would specify the default scheme cap as a reduction by whichever is lesser: some absolute emissions amount (e.g., 12 Mt) or a percentage reduction (four per cent in this example). The default caps could also act as an "upper-bound" for any regulations setting scheme caps. Such an approach would serve as a useful guide, providing certainty that any cap set by regulation will be lower than that set by the default s18. In this case, the default cap would require redesigning from its existing 12 million unit reduction to be appropriate.</p>
3	2	20	<p>The definition of liability as a person who has operational control is a welcome improvement from the CPRS. Operational control is a definition that has been applied for a number of years now under NGERs and increases the likelihood that the holder of a contract to supply will trigger a change-of-law clause to adjust prices for emissions costs.</p>

Clean Energy Bill 2011

Part/s	Division/s	Section/s	Comment
3	3	33	<p><i>Liabe Entity – Supply of natural gas</i></p> <p>The Association commends streamlining the rules for determining liability within the natural gas industry since the CPRS legislation.</p> <p>esaa was supportive in principle of the s33 provisions, which set the point of obligation on the natural gas retailer but wanted to fully understand the definition of a natural gas retailer. It is noted that this has changed to now refer to the supplier of natural gas.</p> <p>esaa notes that a number of important terms such as the definitions of <i>withdrawal</i> and <i>distribution pipeline</i> are to be defined in regulations. We understand that the policy intent is to place the s33 point of liability on downstream natural gas retailer entities. Clear definitions are required to ensure that upstream entities in the natural gas supply chain are not inadvertently captured.</p> <p>It is important that the Government ensures that covered emissions from distribution pipelines remain with distribution pipeline businesses.</p>
3	4	45	<p>States that if an OTN is surrendered or cancelled the Regulator must remove the OTN entry from the OTN Register. esaa recommended in its submission on the exposure draft legislation that under this section the Regulator should be required to publish the date this took effect. This has been reflected in the legislation introduced to Parliament.</p>
3	4	51	<p>This provision should be amended to obligate the OTN holder to inform the retailer that they are no longer permitted to quote an OTN. The section as drafted appears to imply that the OTN holder who ceases to be permitted to quote the OTN does not have to inform the retailer. This would put an unreasonable obligation on the retailer.</p>
3	4	54 and 55	<p>A natural gas retailer becomes liable for supplies that occur 28 days after the surrender or cancellation of an OTN (refer ss54-55). It is recommended that the 28 day period is extended to the next meter read (to a maximum of four months) to ensure that the liability can be taken over based on meter data and adequate notice. esaa notes that an addition has been made to allow for shorter periods when an agreement exists between the OTN holder and the gas supplier.</p>
3	4	59(3)	<p>The notice should also specify the date from which the acceptance of the OTN quotation commences, to ensure clarity as to the timing of obligation transfer between the retailer and the OTN holder.</p>



## Clean Energy Bill 2011

Part/s	Division/s	Section/s	Comment
3	4	64(3)	esaa considers that an amendment is necessary to ensure that suppliers are able to engage in supply having been satisfied that the OTN quoted is legitimate. Liability should remain with the person quoting the OTN in circumstances it becomes ineligible and has failed to give at least 90 days notice to the supplier. Currently drafted the section places the onus on the supplier to ensure that customers quoting OTNs retain these for the duration of the supply. It will be administratively burdensome to require continual checking to ensure OTNs are valid and unreasonable expectation of retailers.
3	5	65	Provides for mandatory designated joint ventures (JVs) to be formed under certain circumstances. The energy industry raised concerns in its submission on the exposure draft legislation around the inflexibility for the point of liability in circumstances where one of the joint venturers is also the operator of the facility. esaa notes that this has now been addressed.
3	5	66	The section outlining notification of new facilities should clarify the 'date a facility becomes a facility' as it applies to construction projects, to ensure it is clear when the 30 days for notification is triggered.
3	5	67	The legislation provides a new approach to apportioning point of liability for JVs when compared to the CPRS. The ability to transfer liability from the operator of a facility to the joint venturers is supported, as such flexibility will allow application of a liability to align with existing commercial practices. Per section 65, the industry notes the changes from the exposure draft to allow one of the joint venturers who is also the operator of the facility to apportion liability across the joint venturers. esaa recommended a change to allow this to occur, and welcomes the amended version.
3	5	70	Outlines criteria that the Regulator must consider when making the declaration about section 68 Application. One criterion is that the participant has the financial resources to comply with the obligations. It is recommended that commentary or regulations clarify what would be required or sufficient in this instance.
3	5	71	The restriction on the start date for a declaration of a JV should not be in 'the same financial year' that the declaration is made but should instead allow the date to be in the previous financial year, as long as it is before the compliance date for that financial year. For instance, if a JV commences in May, the 90-day period for the Regulator to make a decision on the declaration means that the financial year has passed. esaa notes the amendments to this section which allows for a start date in the following financial year if the applicants and operator of the facility to which the declaration relates have consented. However, this does not address our concern relating to the previous financial year.

Clean Energy Bill 2011			
Part/s	Division/s	Section/s	Comment
3	5	75	This section should specify a minimum period of 28 days that can be stipulated in the notice of the Regulator asking for more information in respect to applications under section 74 for a participating percentage determination.
3	5	77	As drafted, this section does not make clear under what circumstances the Regulator would determine the participating percentage on its own initiative.
3	6	Subdivisions A, B, and C	The Act should make clear that there is no earliest time that an entity can apply for a liability transfer certificate (subject to the Regulator being established).
3	6	88	The start date of a liability transfer certificate should not be limited to being in 'the same financial year' as the day on which the certificate was issued but should instead allow the start date to be in the previous financial year, provided it is before the compliance date for that financial year. esaa notes the amendments to this section which allows for a start date in the following financial year. However, this does not address our concern relating to the previous financial year.
4	2	97	The ability to issue units for an eligible financial year in advance of that financial year is supported, as this supports forward-contracting in the electricity market and price discovery, which informs investment and other decisions.
4	2	101	Prescription of a limit on the auction of future vintage units in the legislation is not supported. The industry notes the Government's desire to retain flexibility in setting caps. The specified future vintage auction limit (which comes into effect when there are no regulations in place that set the pollution cap) of 15 million units in the first six months of the year before and 15 million units a year in earlier years is unnecessary. It is also low, given the size of the energy sector's emissions and the established practice of contracting a number of years in advance. It is suggested that this upfront restriction be removed from the legislation, and that the volumes of future vintages auctioned instead be determined in consultation with industry during the establishment of the policies, procedures and rules for auction carbon units as per section 113.
4	4	111(2)	To remove unnecessary working capital costs and barriers to auction participation, the legislation should enshrine the principle of delayed settlement arrangements for units bought at auction. That is, there should be the option for credible auction participants to strike a price for units at auctions conducted by the Regulator but then take delivery and settle those units at a subsequent time, such as at surrender.

Clean Energy Bill 2011			
Part/s	Division/s	Section/s	Comment
4	4	111(5)	It is not clear how the price floor will be implemented with respect to the surrender of eligible international units. It will be important that the proposed approach not apply a one-size-fits-all approach, which could disadvantage entities that purchased international units in good faith. The industry would welcome the opportunity to engage with the government on its proposed implementation arrangements of the price floor as soon as possible.
4	4	113	It is important that the energy industry has an opportunity to work closely with the Government (or with the Regulator, if any power is conferred as per subsection 5) in the formulation of the legislative instrument for the policies, procedures and rules for auctioning carbon units. The involvement of the energy industry is particularly important because auctioned units are likely to primarily relate to energy businesses given: <ul style="list-style-type: none"> <li>- the restricted coverage of the carbon pricing mechanism (around 60 per cent of Australia's emissions);</li> <li>- the large share of energy sector emissions in the covered sectors; and</li> <li>- the fact that other covered sectors will receive significant administrative allocations through the Jobs and Competitiveness Program.</li> </ul>
6	2	123	The provision that regulations prohibiting the surrender of specified eligible international units take effect from the financial year after the regulations are registered is not supported. This does not provide sufficient notice to businesses of a change of law and is an inappropriate allocation of risk. Furthermore, it discourages the development of international emissions markets as it creates risks for businesses in establishing contractual arrangements for supplies of international permits. While noting the need to ensure the environmental integrity of the scheme, it is suggested that there be no retrospective application of any changes in eligible international units (noting that the Government has the option of purchasing additional abatement to redress any environmental concerns). Alternatively, compensation could be paid to the holders of prohibited international units negatively adversely affected by the change of eligibility.
7			It is requested that the regulations on the Jobs and Competitiveness Program be made available for stakeholder review and input as soon as possible.

Clean Energy Bill 2011

Part/s	Division/s	Section/s	Comment
8			<p><i>Payment for Closure</i></p> <p>The Government's Clean Energy Future policy includes a payment-for-closure option. This is largely addressed outside the bill; however, esaa notes the addition of section 303A which sets a basis for these contracts. To support a smoothly functioning energy sector it is important that the industry – including generators that may close, other existing generators that will continue to operate in the market, and potential investors – have clear and timely information on how this payment for closure will operate. Key matters include the timelines for expressions of interest, contract negotiations, announcements, execution and any role and responsibilities of the market operator or other bodies (such as the Energy Security Council). Also of importance is the provision for decisions on agreed closures to be cancelled or delayed and how any such decisions will be made. The industry would welcome the opportunity to engage Government in establishing the details of this process.</p> <p><i>The Energy Security Fund</i></p> <p>The Energy Security Fund in the Government's Clean Energy Future policy includes an upfront \$1 billion cash component paid in the 2011-12 financial year ahead of the scheme's start. This cash component is not explicitly referred to in the bill. To provide certainty and confidence to industry about this cash component and the way it will be allocated, it is suggested that these matters be identified in the bill. In addition, provision should be made in the bill that, should the \$1 billion not be allocated as currently proposed, an allocation of Australian carbon units of equivalent value will be made (including an adjustment for the time value of money).</p> <p><i>Loans for refinancing and auction purchases</i></p> <p>The Government's Clean Energy Future policy includes loans for refinancing and for the purchase of units at auctions. esaa requested that these measures be specified in the bill in its submission on the exposure draft legislation, which appears to have been reflected in section 303B. In addition, the Government's proposed Energy Security Council is not addressed. It is important that the nature and role of the Energy Security Council be made known to the market as soon as practicable. The industry would welcome the opportunity to engage Government on the development of the Council.</p> <p><i>Windfall Gains Test</i></p> <p>The removal of the windfall gains test from the requirements is supported.</p>
8	3	162	<p>esaa advocated for changes to the timeframes in this section which have been addressed. Applicants now have 30 days from the commencement of this section to make an application for certificate of eligibility for coal-fired generation assistance..</p>

Clean Energy Bill 2011			
Part/s	Division/s	Section/s	Comment
8	3	165	The Regulator's response to an application for the issue of certificate of eligibility for coal-fired generation assistance must be provided within the later of 90 days from the date on which the application was made or 150 days from the commencement of this section. esaa acknowledges the reduction of the timeframe from 300 days to 150 days compared with the exposure draft. The Association raised concerns around the timeframes and welcomes the change.
8	4	170	<p>The industry supports the improvements made to the Power System Reliability Test as compared to the CPRS, including inserting a timeframe for the market operator to make a statement and clarity that if the market operator does not make a statement the test is taken to be passed. However, there is still uncertainty about how the Power System Reliability Test will operate. For instance, what criteria will guide the manner in which the energy market operator determines whether there is likely to be a breach of relevant power system reliability standards, or how multiple applications for capacity withdrawal received simultaneously are to be assessed? The Association would welcome the opportunity to provide comments and feedback on appropriate regulations or other instruments to help develop this test.</p> <p>It is also noted that the decision of the appropriate energy market operator about power system reliability is not presently a reviewable decision under Part 21. Given the importance of such a decision, it is considered that this decision should be included as a reviewable decision.</p>
8	4	171	An important feature of the CPRS low emission transition incentive, that is, the treatment of replacement capacity, was the flexibility provided for market participants. In effect, the operator of an eligible coal-fired generator, could withdraw capacity, and commercially negotiate for another party to nominate their new capacity as replacement. There are two key benefits of such flexibility. Firstly, it doesn't bind an incumbent market participant to reinvesting in new low emission capacity, and secondly, owing to this flexibility, would likely encourage the earlier entry of new low emission capacity. The industry considers the current drafting is not clear on whether such flexibility has been retained, and recommends clarity in the provision is provided.
8	4	172 (1)(f)	The emissions intensity threshold of 0.8 tCO <sub>2</sub> -e/MWh for replacement capacity under the Power System Reliability Test is unnecessary and could be damaging to the energy market. The 0.8 tCO <sub>2</sub> -e/MWh threshold may not be consistent with the most appropriate type of investment at the relevant point in time, taking account of emission prices and other relevant factors such as relative fuel prices and market conditions. As the emissions price mechanism is in place to provide signals to investors about emissions abatement policy, and the objective of the Power System Reliability Test is to support reliability, there is no justification for the threshold. Not having a threshold would be consistent with the object of this Part of the bill, which refer to underpinning the investment generation assets needed to ensure that Australia's future energy security needs are met (i.e., the object of this part does not relate to emissions abatement).

Clean Energy Bill 2011

Part/s	Division/s	Section/s	Comment
8	6	181	<p>esaa argued that under the exposure draft legislation and commentary that administrative allocation of units to non-closing generators would not be affected by a closure contract.</p> <p>The Association also requested clarification in the legislation about whether a generator that agrees to a closure contract, where the closure occurs after the 2016-17 financial year, would not be issued with any units according to this Part (or, alternatively, would continue to be issued units as the closure related to a point in time after the termination of the Energy Security Fund allocations). The amendments to this section appear to address this concern.</p>
9	2	184	<p>This section requires the Regulator to make an entry in the Liable Entities Public Information Database if it has reasonable grounds to believe that a person is, or is likely to be, a liable entity for an eligible financial year. It is not clear on what grounds a Regulator could form this opinion, for instance, with respect to new facilities that could become operational in the upcoming financial year. From a market disclosure point of view, it would be disappointing if the Regulator formed a view about a new facility before the owner had finalised commencement, advised the ASX, etc.</p>
9	2	187	<p>This section requires the Regulator to make an entry in the Database if it is of the opinion that the person has a unit shortfall charge for the eligible financial year. It is not clear that any information published under this section could reasonably be published only when the deadline for surrendering units has passed for an eligible financial year. It could harm an entity's reputation if the Regulator published 'expected' shortfalls before participants were required to surrender units. It is assumed that the section would operate only after 15 June and 1 February in fixed-charge years and after 1 February in floating-charge years, but this should be made clear in the wording.</p>
9	2	189	<p>The requirement of the Regulator to publish in the Database, at the individual liable entity level, the breakdown of surrendered units by type – carbon units, eligible international emissions units, Australian carbon credit units – is considered excessive. Only aggregate information regarding the breakdown of unit types should be made public, as this is sufficient to meet the objective of transparency while balancing the need to protect commercial sensitivity.</p>



Clean Energy Bill 2011

Part/s	Division/s	Section/s	Comment
13		221	<p>The industry does not support empowerment of the Regulator to require information or documents simply in relation to the operation of the Act or associated provisions. Legal advice obtained with respect to the CPRS advised that, similar to s28(1) of the <i>National Electricity Law</i>, the powers conferred should be more exact and confined. It is proposed that the powers be confined to information or documents required by the Regulator for the performance or exercise of its powers and functions, only in circumstances where the Regulator has reasonable belief that a breach has occurred.</p> <p>With respect to compliance (subsection 4), it is noted that the previous CPRS drafting has been modified slightly to include “to the extent that the person is capable of doing so”. It is suggested that this improvement be built upon by adding ‘practically capable’, or ‘reasonably capable’ of complying.</p>
15	6	245	<p>The drafting for <i>Monitoring warrants</i> is based on its being “reasonably necessary” for purposes of establishing compliance or substantiating information. There is no explicit requirement for a reasonable belief of breach or non-compliance. This section should be amended to refine the scope and ensure appropriate use of the monitoring powers.</p>
20		278	<p>It is recommended that the Regulator’s ability to cancel an undertaking should be subject to the consent of the relevant party(s).</p>
21		281	<p>This section outlines the decisions which may be eligible to be reviewed by the Regulator. The Association considers that the Power System Reliability Test should be a reviewable decision under this Part of the bill.</p>
22	2	290	<p>The exposure draft did not stipulate that the Climate Change Authority must make provision for public consultation for reviews under Section 290 as it does for review under Sections 288, 289, and 291. esaa called for this to be changed and notes that this has been amended.</p>

**Clean Energy (International Unit Surrender Charge) Bill 2011**

Part/s	Division/s	Section/s	Comment
		8	<p>The proposed approach of a surrender charge on international permits in order to enforce a domestic floor price raises a number of concerns. Most significantly, it could result in a floor price that is unique and different for each participant who surrenders international units. Every entity will likely have incurred a different price for CERs, and a single “top up” amount would result in a differing floor price enforced on each participant. The industry urges the Government to consult early on regulations to set the operation of the floor price, and suggests that if there is to be a singular charge, it is published as a forward curve by 1 July 2012, to allow market participants to contract in international permits with full information.</p>