Senate Finance and Public Administration Legislation Committee
ANSWER TO QUESTION ON NOTICE
Prime Minister and Cabinet Portfolio
Department of Climate Change
Budget Estimates Hearing–May 2009

Written question reference: CC66a-h
Outcome/Output: Outcome 1, Output Group 1.1 – Response to climate change
Topic: CPRS and Climate Change
Hansard Page: Not relevant for written QoN

Question: (Senator Cash**)**

a) Did Treasury modelling use the same competitive spot market assumptions made for the Eastern States Electricity Market in its assessment of the need for ESAS assistance in Western Australia.

b) Has Griffin Energy raised with either the Minister or the Department that there is a historic price competition between gas and black coal in the Western Electricity Market and state that WA's long term security of supply will likely be compromised by the current CPRS settings?

c) Has Griffin Energy raised with either the Minister or the Department that in the selling model the price of electricity is locked in for the length of contracts and there is no capacity in the Western Electricity Market to pass through to consumers the increasing price of carbon, which the generators will bear over 15 years. By contrast in the National Electricity Market Model, based on competitive spot prices, the additional cost of carbon over 15 years will be passed through via the market clearing price.

d) Has Griffin Energy put forward a solution to this problem?

e) If so, what was this solution?

f) Given the fact that the Western Electricity Market will be based increasingly on gas and renewable energy while the Eastern Market will remain coal based, what changes have been made to the proposed CPRS legislation to recognise that different circumstances apply in WA to ensure that discrimination does not occur?

g) Does the Government have any strategy to address this issue? If so, what? If not, why not?

h) Will the long term energy security in Western Australia be negatively impacted if the Government's legislation is passed?

Answer:

a) Prior to making policy decisions on the Carbon Pollution Reduction Scheme (CPRS) in the White Paper, the Government undertook three major pieces of wholesale electricity market modelling. These were undertaken by:

- McLennan Magasanik Associates (MMA) for the Treasury;

- ACIL Tasman for the Department of Climate Change; and

- ROAM Consulting for the Department of Climate Change.

All three modelling agencies separately modelled the National Electricity Market (NEM) and the Western Australian Wholesale Electricity Market (WEM). The modelling recognised that the WEM is not connected to the NEM, and the particular fuel mix of the Western Australian market.

Specifically the economic modelling undertaken by MMA for Treasury, released by the Government in *Australia's Low Pollution Future: The Economics of Climate Change Mitigation,* included detailed bottom-up electricity generation sector modelling that examined the implications of emission pricing on a generator by generator basis.

MMAs detailed analysis took account of the existing structure of the electricity sector in Australia and separately modelled the NEM, South West Interconnected System, the Darwin Katherine Interconnected System and off-grid electricity systems. Each geographical electricity market was modelled according to its current market rules and specifications, the details of which are outlined in the detailed consultancy report produced by MMA and placed on the Treasury website.

Electricity prices varied across states, as highlighted in tables 6.14 and 6.15 of the report.

b) While it is not appropriate to reveal the content of discussions between Government and individual companies, the issues outlined in the question have been raised in publicly available submissions.

Electricity market modelling commissioned by the Government indicates that coal-fired electricity generation continues to play a significant role in the WEM, and did not indicate that the long term security of supply of electricity in the WEM was likely to be compromised by the introduction of the CPRS.

c)-e) The issues outlined in the question have been raised in publicly available submissions.

It is the Department’s understanding that long-term non renewable contracts are not the only or predominant mode for electricity transaction in the WEM and that carbon costs can be readily passed on in many cases, subject to accommodating decisions on retail price regulation.

On the issue of long term contract, many long-term electricity supply contracts do allow for a significant degree of carbon cost pass through. Many parties to such contracts have anticipated the introduction of a carbon price and managed the risk of this outcome in their contracts.

The Senate Standing Committee on Economics commented on this issue in its report into the ‘Exposure draft of the legislation to implement the Carbon Pollution Reduction Scheme’:

> “Equity issues arise where it is proposed to intervene in contracts negotiated in recent years, which either failed to consider the potential for a carbon price or that were technically defective in creating terms to deal with the possibility.

> The committee considers it very likely that a significant number of the contracts in question failed to anticipate the introduction of emissions trading, and hence a carbon price, at a time when this was at the very least a reasonable prospect. It would be inappropriate for the government to intervene in order to make good any such failure."

The Government would impose significant risks and costs on taxpayers if it provided up-front transitional assistance measures on the basis of contractual impediments to carbon cost pass-through. The Government would face significant difficulties in accurately determining the economic impact of the CPRS on parties to a given contract before those parties have been able to determine the nature of pass-through that exists in that contract.

While reluctant to intervene in the contractual arrangements of private parties, the Government will continue to monitor the interpretation and renegotiation of contracts in the lead up to the introduction of the CPRS.

f)-g) The Government's modelling separately modelled the WEM. The modelling recognised that the WEM is separate to the NEM, and that these two markets use different mixes of generation technologies and fuels.

This modelling suggested an ongoing role for both coal and gas generation in both the WEM and the NEM. It did not suggest that the CPRS would impact on energy security in the WEM relative to the NEM.

h) Modelling undertaken by the Government shows that the long term security of supply of electricity including long term dispatch of electricity into the WEM and the NEM is unlikely to be compromised by the introduction of the CPRS.

The CPRS is a broad-based policy tool, which can draw upon abatement opportunities wherever it is most cost effective to do so, including by drawing upon international sources of abatement (through international linking). Further, the Government has decided to delay the start of the CPRS by one year and introduce a one year fixed price phase to further help companies manage the transition to the CPRS and the impacts of the global recession.

Furthermore, the Western Australian State Government submission to the Green paper states 'the State Government considers that energy security implications for Western Australia from the proposed CPRS are likely to be limited. Coal-fired generation in Western Australia will remain viable at high gas prices and while carbon prices are relatively low. Furthermore, the WEM is designed to deliver greater investment certainty through the incorporation of the Reserve Capacity Margin.'

The Reserve Capacity Mechanism is a set of processes through which the Western Australia's Independent Market Operator determines the amount of generation and demand side management capacity required to meet future demand and facilitates the provision of this to the market.