

A few
words.

John Hawkins
Committee Secretary
Senate Select Committee on Climate Policy
GPO Box 6100
Parliament House
CANBERRA ACT 2600

9 April 2009

Dear Mr Hawkins,

AGL welcomes the opportunity to provide a submission to the Senate Select Committee on Climate Policy. AGL is a strong supporter of the Carbon Pollution Reduction Scheme and Renewable Energy Target legislation. We believe that it is critical that the schemes be implemented on time to provide investment certainty. Without this certainty, there will be delays in investment and security of supply could be compromised in the medium term.

AGL is Australia's leading integrated renewable energy company with 3.2 million customer accounts. Drawing on over 170 years of experience, AGL operates retail and merchant energy businesses, power generation assets and an upstream gas portfolio. AGL has Australia's largest retail energy and dual fuel customer base. AGL has a diverse power generation portfolio including base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources including hydro, wind, landfill gas and biomass. AGL is Australia's largest private owner and operator of renewable energy assets and is looking to further expand this position by exploring a suite of low emission and renewable energy generation development opportunities.

AGL has been preparing for a carbon constrained future for several years. We are the only Australian utility to have joined the Chicago Climate Exchange. This commitment involves a legally binding emission reduction obligation. In 2008, we were also the first Australian company to forward trade Australian Emission Units (AEUs). This action was taken to provide electricity market participants with carbon hedging facilities to improve liquidity in forward electricity markets.

AGL is well placed to comment on the concepts of emissions trading and renewable energy due to the diversity of our business. There will be a number of impacts on AGL as a result of the implementation of the Carbon Pollution Reduction Scheme on the AGL business. These can be summarised as: increased wholesale costs; compliance costs; and investment incentives.

- **Increased Wholesale Energy Costs:** AGL is Australia's largest retailer of electricity and gas. In 2007/08, the greenhouse gas emissions produced in association with the supply of AGL customers totalled 53.3 million tonnes. This is around 10% of Australia's total greenhouse gas emissions. While AGL will not be required to purchase Australian Emission Units (AEUs) for these emissions, we will be required to pay higher costs for energy as generators and gas producers pass through carbon costs in the form of higher energy contract prices. At a carbon price of \$20, this is likely to result in an increase in wholesale energy costs of close to \$1 billion.

AGL believes that energy efficiency is likely to play a significant role in minimising cost impacts on consumers. The South Australian and Victorian Governments have already implemented residential energy efficiency schemes and the NSW Government is in the process of implementing a similar scheme. A national approach to energy efficiency policy is likely to provide significant benefits for residential and commercial and industrial consumers of energy.

- Compliance Costs: AGL will be responsible for surrendering Australian Emission Units (AEUs) for the greenhouse gas emissions produced as a result of the combustion of natural gas by our residential and small business customers. At a carbon price of \$20, this is likely to result in an increase in compliance costs of around \$200 million.
- Investment Incentives: The Carbon Pollution Reduction Scheme and Renewable Energy Target will provide investment certainty for new gas-fired and renewable power projects. Power stations generally have asset lives of several decades and certainty about their long-term prospects is vital to secure capital. The Schemes will allow energy companies like AGL to integrate carbon and renewable pricing into business decision making and invest in capital with these types of long asset lives.

AGL has already commenced putting in place systems and processes for managing these risks and opportunities. This is largely because emissions trading and a clean (or renewable) energy target were election commitments of both major parties in the lead up to the 2007 Commonwealth election. AGL believes it would create significant regulatory uncertainty and sovereign risk if the proposed Carbon Pollution Reduction Scheme and Renewable Energy Target are not implemented on 1 July 2010 and 1 January 2010 respectively.

There are two primary changes to the Carbon Pollution Reduction Scheme AGL believes could be considered by Government to enhance investment certainty and minimise the transitional impacts associated with the introduction of the scheme: the introduction of deferred settlement for liable parties; and an extension of assistance provided through the Electricity Sector Adjustment Fund.

- Deferred Settlement: Businesses with large carbon liabilities will be required to forward purchase Australian Emission Units (AEUs) to manage the risks associated with forward contracting of their products. As such, there is likely to be an increase in the working capital required by these businesses to operate on a business as usual basis. The current state of credit markets may be a barrier to businesses raising this working capital efficiently. However, the introduction of deferred settlement would overcome this short-term issue. Businesses would be able to purchase Australian Emission Units (permits) at auction but settlement (payment) would not occur until the business surrendered the permits for compliance purposes. The permits would not be tradeable until the business has paid for them.
- Electricity Sector Adjustment Fund: AGL strongly supports the concept of an Electricity Sector Adjustment Fund. While not benefiting directly, Loy Yang Power (of which AGL owns 32.5%) will receive free Australian Emission Units (AEUs) through the Electricity Sector Adjustment Fund. While the Fund will provide assistance over the first five years of the scheme, many of the impacts on generators (particularly black coal generators) will occur after 2015. Accordingly, AGL believes it would be prudent for the Electricity Sector Adjustment Fund to be extended beyond 2015. This would assist with the prevention of large asset value write-downs which could impact on the credit worthiness of generation companies.

With regard to the expanded Renewable Energy Target, AGL believes that it is critical that the penalty be increased from its current level of \$40/MWh. The cost of capital for renewable projects has increased for a number of reasons in recent years. At the same time, the penalty has decreased significantly in real terms over recent years as it is not



indexed. AGL believes that in addition to being increased, the penalty should also be indexed over time to ensure it remains constant in real terms. While the cost of renewable technology should fall over the longer term, it is important that the penalty be set at a high enough level to ensure that short-term cost issues (such as the current increased cost of credit associated with the global financial crisis) do not result in non-compliance.

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

Attached to this statement are AGL's submissions on the Green Paper and the Renewable Energy Target draft legislation. Should you have any questions or comments on this statement or the attached submissions, please contact Tim Nelson, Head of Carbon Origination and Government Affairs on (02) 9921 2516 or at tanelson@agl.com.au.

Yours sincerely

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