Carbon Pollution Reduction Scheme Green Paper

AGL Submission to the Department of Climate Change

Date: 10 September 2008

Executive Summary

AGL believes that the Carbon Pollution Reduction Scheme Green Paper (Green Paper) released by the Federal Government (Government) provides an effective framework for managing Australia's transition to a carbon constrained environment.

AGL accepts the scientific consensus that the concentration of greenhouse gases in our atmosphere needs to be stabilised at levels to avoid 'dangerous' climate change. AGL supports three key policies to achieve these targets and mitigate the costs associated with climate change. Importantly, each of these three policies are effectively accounted for in the Green Paper;

› Expedited development and implementation of a national emissions trading scheme which uses a broad long-term GHG emissions reduction target as its goal with interim targets in place to guide investment decision making;
› The deployment of clean technologies through a single national clean energy obligation; and
› Appropriate transition arrangements particularly in sectors of the community and economy which are likely to suffer disproportionate disadvantage – e.g. coal fired generation plant and the communities reliant on that economic activity, consumers in financial hardship.

AGL is largely supportive of the policy positions suggested in the Green Paper, specifically;

› The introduction of a broad based cap and trade emissions trading scheme on an expedited basis, thereby providing certainty to Australian industry and facilitating the adaptation to a carbon constrained economy;
› The creation of the basic permit underpinning this cap and trade scheme as a defined, secure property right, which can be freely traded in transparent, open Government auctions and in a secondary market;
› A clear process for establishing scheme trajectories, with a firm cap of 5 years and a gateway of 10 years beyond that. This will provide firms with the necessary certainty and retain sufficient flexibility for Government to adjust to overseas developments;
› The provision of compensation for strongly affected industry and emissions intensive, trade exposed industry; and
› The provision of assistance to households and businesses with a view to mitigating the impact of the transition to a carbon constrained environment.

However, there are some policy positions which AGL suggest require amendment or augmentation. The most significant of these are as follows:

› AGL suggests that the objectives of the scheme should make specific reference to allocative or pricing efficiency. The prices of carbon based energy products must be determined by market forces in order for the CPRS to achieve the necessary abatement targets over the long-term. Further, specific provision must be made to ensure energy retailers are not prevented from passing on the full costs associated with the introduction of the CPRS to consumers.
› AGL suggests that the borrowing arrangements suggested by the Government should be extended to include a 'non-compliance' threshold, whereby liable firms are able to meet 5% of their emissions liability using future permit vintages; and

› The Government should provide delayed settlement terms (for liable parties only) when permits are purchased through the auction process. AGL suggests that in order to ensure a degree of stability in the energy market, minimising the cash flow impact on large emitters should be a key auction design criteria.

AGL encourages the Government to ensure stakeholders are closely involved in further consultations on the development of the CPRS. Areas of particular interest to AGL include:

› The practical operation of the auction process and the building of the software operating auction platform. Ongoing engagement in this area will ensure stakeholders have a comprehensive understanding of the mechanics of the process prior to the first auction; and

› The calculation of the 'energy factor' which will be used to determine the difference in the cost of electricity under the CPRS with that which would have occurred in the absence of the CPRS.

Introduction

AGL Energy (AGL) is Australia's leading energy company. We operate across the supply chain and have investments in energy retailing, coal-fired electricity generation, gas-fired electricity generation, renewables and upstream gas extraction. The diversity of this portfolio has allowed AGL to develop a detailed understanding of emissions reduction opportunities.

AGL is Australia's largest retailer of gas and electricity with approximately 3.2 million customer accounts in New South Wales, Victoria, South Australia and Queensland. AGL has significant investments in upstream energy markets. We own and operate 645 MW of hydroelectric power generation assets, the 1280 MW Torrens Island Power Station and the Somerton gas-fired power station. AGL also has a 32.5% equity investment in the Loy Yang A power station. AGL recently opened the 95 MW Hallett wind farm in South Australia which is the 'first stage' in what will eventually be one of the largest wind farms in Australia.

AGL is developing a number of new energy assets. It is important to note that all of these assets are consistent with a carbon constrained future. The assets in development include Stage 2, 3 and 4 of Hallett wind farm (71MW, 90MW and 189 MW respectively), Bogong hydro power generator (140 MW), Victorian wind farm sites (Macarthur 330 MW), Leaf's Gully gas fired-power station (350MW), SE Qld gas fired-power station (350MW), Kogan gas fired-power station (350-800MW), and North Qld gas-fired power station (350 MW).

This submission provides detailed views on various aspects of the Green Paper released by the Commonwealth Government. The submission contains thirteen sections based upon the Chapters in the Green Paper. The submission also contains an Appendix outlining AGL's position on each question raised in the Green Paper. For further information on any of the issues outlined in this submission, please contact: Beth Griggs, Head of Policy and Regulation on (03) 8633 6077 or at bgriggs@agl.com.au; or Tim Nelson, Head of Carbon Origination and Government Affairs on (02) 9921 2516 or at tanelson@agl.com.au.

1. Framework for the Carbon Pollution Reduction Scheme

AGL strongly supports the Government's decision to address climate change through the introduction of a 'cap and trade' emissions trading scheme. AGL agrees that the introduction of a broad-based emissions trading scheme will promote the most cost-effective abatement across the Australian economy.

Objectives of CPRS

AGL supports the objectives suggested in the Green Paper, but believes that there needs to be specific recognition within the objectives statement that in order for the stated purpose of the CPRS to be achieved, the cost of carbon must be fully passed through to consumers. If the cost of carbon is not fully factored into retail energy tariffs, consumers will not adjust their behaviour and the longevity and success of the scheme is likely to be threatened.

2. Coverage

Policy Principles for Coverage and Points of Liability

AGL has previously stated in submissions to governments that when assessing which sectors should be covered, the following principles should be adopted:

› Potential for Emission Reductions: Sectors that have no potential to reduce emissions should not be covered by an emissions trading scheme. Instead, policies should be established that focus on technological improvements and other factors that will drive emission reductions over time.

› Suitability of Emissions Trading: Some sectors are more suited to emission trading than other policy responses and vice versa. For example, AGL agrees that it would be very difficult to place liabilities on livestock emissions. Governments should develop other emission reduction policies for sectors that are not suited to emissions trading.

› Emissions Contribution of Sector: Consideration should be given to the total emissions of the sector relative to the overall emissions footprint – the cost of including a sector in the trading scheme should not outweigh the benefit from abatement likely to be achieved.

› Existing Reporting and Regulatory Frameworks: Where possible, existing regulatory and reporting frameworks should be employed so as to minimise the reporting burden on businesses. Further, government attention should be turned to streamlining existing reporting obligations across jurisdictions to provide a single, nationally consistent reporting framework.

Coverage of Greenhouse Gases

AGL supports the inclusion of all greenhouse gases included under the Kyoto Protocol. Reducing emissions of greenhouse gases other than carbon dioxide may be a more cost effective way of reducing greenhouse gas emissions in the short-term than reducing carbon dioxide alone.

AGL agrees that the threshold of 25,000 tonnes would strike an adequate balance between the benefits of broader participation and ensuring that the costs of compliance do not outweigh these benefits. Further, given the desirability of applying the existing reporting framework under NGERs, a threshold as suggested in the preferred policy position is supported.

Coverage of Specific Sectors

As noted above, AGL endorses a broad based emissions trading scheme. AGL's specific comments in respect of the sectors most relevant to its operations are:

Electricity Generation

AGL supports the coverage of electricity generation with generators being liable parties from the commencement of the CPRS as suggested in the Green Paper.

Natural Gas

AGL supports the allocation of liability as suggested in the Green Paper, which would render:

- Gas-fired generators and commercial and industrial gas users liable for combustion emissions over 25 kt per annum; and
- Natural gas retailers liable for the emissions from the combustion of natural gas provided to small emitters (e.g. retail customers).

AGL supports this position on the assumption that jurisdictionally regulated natural gas tariffs are adjusted to fully pass through the costs of:

- The uplift in wholesale gas prices associated with carbon emitted by producers and pipeliners of natural gas; and
- Securing permits for the emissions attributable to the small retail customers.

AGL also believes that gas-fired generators and commercial and industrial combustion emissions greater than 25kt should be required to inform their gas retailer that they are managing their own liability. This will ensure that retailers do not surrender certificates for customers with emissions above 25 kt that are managing their own liability.

Waste

AGL does not support the coverage of waste facilities in the CPRS. Operators of landfill facilities are unlikely to be significant traders of permits, and the transaction costs associated with the inclusion of waste are likely to be higher than any benefits achieved for smaller landfills. AGL is of the view that the same economic incentive for abatement can be achieved through allowing reductions in waste related emissions to be included as offsets using existing frameworks such as the NSW Greenhouse Gas Abatement Scheme and Greenhouse Friendly.

It should be noted that in the event landfill is included, abatement projects such as methane flaring projects, will no longer be entitled to the revenue stream currently achieved by way of abatement credits (such as NGACs or offsets acredited by the former Australian Greenhouse Office). The CPRS should therefore be structured so as to ensure these projects are still securing the same 'per tonne' revenue so as to guarantee the continuing abatement. AGL suggests this could be achieved by:

- Allocating emission permits (under the CPRS) for eligible abatement achieved between 3 June 2007 and the commencement of the CPRS; and
- An upfront allocation of permits for the abatement that will be achieved over the life of the abatement project. For example, if a landfill would have produced 25 kt of emissions under the CPRS, but a flaring project is installed and reducing emissions by 20 kt, the operators of the project should be entitled to an upfront permit allocation of 20kt per annum for the life of the project.

If waste is deemed a covered sector, the organisations responsible for the emissions (e.g. local government waste facilities) will be required to purchase 25 kt of permits, either through:

- Funding the supply of 'abatement credits' to the project operator to enable the project to continue. In the example set out above, this would equate to 20kt worth of permits for the life of the project paid to the project operator and 5 kt of permits purchased at auction or through the secondary market; or

- Acquiring the necessary permits to cover the full amount of emissions – i.e. If the abatement project is discontinued due to lack of funding revenue, then 25kt of permits must be acquired.

Agriculture

The Green Paper states that the Government is of the preliminary view that agriculture emissions will be included in the CPRS by 2015, but this will not be finally decided until 2013.

AGL does not support the incremental inclusion of sectors in the CPRS unless the decision to phase sectors in is made prior to the commencement of the scheme. The inclusion of sectors after the commencement of the scheme could significantly alter the emission reduction target, and the level of abatement available to meet that target under the CPRS. As the price of permits will be determined by the overall target and the cost of abatement options available, phasing in the additional sectors is likely to significantly alter long term prices and lead to increased price volatility. AGL is firmly of the view that coverage should be determined prior to the commencement of the scheme.

LPG

AGL supports the application of liability as suggested, as it allows for the 'netting out' of large LPG users and enables them to manage their own liability. This approach is consistent with that suggested in respect of liability for emissions from natural gas combustion.

However, consideration needs to be given to two issues which if not addressed could create significant distortions in the market:

- The incentive to produce domestic LPG will be significantly reduced as the additional costs associated with sourcing AEUs will not be experienced by overseas producers. As such, LPG production should be considered an EITEI and subject to the same compensatory mechanisms as other EITEIs to prevent this distortion;
- The incentive to use LPG instead of petrol due to its lower emissions intensity will be removed if the excise rebate is paid to petrol consumers but not LPG users. This requires careful consideration by the Government. AGL believes that the introduction of excise on LPG should be postponed to prevent this competitive disadvantage being realised.

LNG

AGL supports the application of liability as suggested in the Green Paper, provided that there are appropriate arrangements made to ensure that exported LNG is able to be 'netted out' from the domestic emission liability.

Biofuels and Biomass

AGL supports the policy position suggested by the Government whereby emissions resulting from the combustion of biofuels and biomass in the creation of energy would not be covered under the scheme.

Netting Out Arrangements

AGL is very supportive of the suggestion in the Green Paper that large direct emitters would need to declare their intention to manage their own liability prior to the commencement of the relevant compliance year. These organisations would then be required to manage their own liability, irrespective of whether their direct emissions exceeded the 25kt threshold or not. Upstream suppliers (such as natural gas retailers) should not be in any way liable for the emissions of these customers within that compliance period.

In the event the direct emitter wished to have responsibility for their emissions accounted for by the upstream supplier, they would need to declare this three years prior to the commencement of the relevant compliance period. This is necessary for a retailer to have the appropriate level of notice to ensure that this increased liability can be managed across its carbon trading portfolio in the most effective and efficient manner. Further, the CPRS must be structured to ensure that upstream suppliers cannot be required to accept liability for customers where contractual arrangements do not support the price pass through to the customers.

Offsets

AGL notes that the Green Paper only envisages possible offsets from the forestry sector at this stage, whereby offsets may be created for any abatement activity undertaken. As noted above, AGL believes that waste, agriculture and forestry should be excluded from the scheme from the outset, and domestic offsets able to be created from abatement activity in each of those sectors.

AGL also supports the inclusion in the scheme of international offsets recognised under the Kyoto Protocol.

3. Carbon Market

AGL believes that the Green Paper outlines an effective structure for an efficient, transparent carbon market. AGL agrees that the principles of allocative efficiency and efficient price/information discovery are essential for an efficient, functioning market and believes these principles are well reflected in the structure proposed in the Green Paper.

AGL endorses the approach suggested in the Green Paper whereby:

› Permits are to be created as secure property rights. This ensures that the value of the permits cannot be removed through Government policy change without compensation;
› There is only one form of permit created, which is an annual permit uniquely identified and 'date stamped' with the first year it becomes valid for surrender (except where surrendered early under the proposed 'borrowing' provisions);
› The scheme would permit unlimited banking, and a form of borrowing (this is discussed further below);
› There would be a compliance period of one year, but with flexibility being provided in the banking and borrowing arrangements;
› A price cap in the form of an administrative penalty, with no 'make good' provision should be established to ensure a smooth, controlled transition to the CPRS.

AGL does have some concerns with a number of stated policy positions, which are detailed further below.

Borrowing under the CPRS

AGL agrees that there needs to be sufficient provision for borrowing AEUs from future years to meet a current liability. This provides liable entities with sufficient flexibility in meeting their liabilities, particularly in the early years of the operation of the CPRS while firms are adjusting to their levels of liabilities and the operation of the market.

However, AGL is of the view that the borrowing policy suggested in the Green Paper should be augmented by allowing firms to carry over 5% of their liability into the future years – i.e. There should be two forms of borrowing permitted amounting to a borrowing limit of 10% of the total liability:

› 5% of a firm's liability could be met by the surrender of AEUs from future years; and
› 5% of a firm's liability could be met in the surrender of permits in the next year.

AGL believes this is necessary in order to provide the sufficient level of flexibility for managing a trading position. AGL is concerned that in the absence of a 'non-compliance' element to the borrowing arrangements, there could still be higher degrees of price volatility, particularly if the position of large emitters is known in the market and speculators seek to squeeze a pre-surrender date market.

Permits should not be financial instruments

The Green Paper currently suggests that permits should be considered financial product for the purposes of Chapter 7 of the Corporations Act 2001. AGL does not support this position for the following reasons:

- Deeming AEUs to be financial products will increase the implementation costs to scheme participants, as they will need to obtain a financial services licence or revise an existing licence in order to be authorised to deal in the permits or to advise in relation to AEUs.
- AEUs are more akin to other environmental products and commodities than they are to shares or debentures. In particular there is little expectation that AEUs will be traded by retail clients. No other emissions trading scheme established has deemed an emissions trading permit to be a financial product per se.
- In the initial auction process, the Government is the issuer of the permits and will establish the auction rules. It therefore should not be considered necessary to regulate the initial auctioning process under Chapter 7.
- Where permits are traded as derivatives, the existing regulatory infrastructure provided in Chapter 7 of the Corporations Act 200, which addresses the regulation of formal financial markets, market misconduct and financial advice, will apply.
- Deeming AEUs as financial products would erect a barrier to international trade which may affect international linking opportunities with other schemes.

Price caps

AGL supports the concept of placing an upper limit on the price of permits, particularly in the early years of the scheme. AGL is of the view that this should take the form of a penalty payment with no make-good provision. AGL suggests this approach will have a smaller impact on the ability of the Government to manage its own Kyoto liabilities.

Information disclosure

AGL does not support the disclosure of non-compliances from firms or in sectors, unless it is provided in such a way as to ensure the identity of the non-compliant firms are concealed. This is necessary to ensure that other participants do not exploit the market position (i.e. short position) of a non-compliant firm.

4. Emissions Targets and Scheme Caps

AGL is very supportive of the mechanisms for advising of future targets proposed in the Green Paper. AGL believes that the timeframes and 'gateway' based approach provides investors with the requisite level of certainty while maintaining sufficient flexibility.

The gateways, in combination with flexibility provided by robust banking and borrowing arrangements, provides liable firms with the certainty and flexibility necessary to effectively manage their liability.

5. Reporting and Compliance

AGL agrees that the CPRS reporting and compliance regime should be based on the National Greenhouse and Energy Reporting Scheme (NGERS). While AGL recognises that NGERS was not initially intended to cater for CPRS obligations, AGL believes that any issues arising from this can be managed through some relatively minor modifications following further consultation with industry.

In respect of the policy positions suggested by the Government, AGL notes that:

› Assigning liability for reporting under NGERs, and therefore liability under the CPRS, on the basis of 'operational control' is problematic. However, AGL suggests that a mechanism be considered whereby firms are able to nominate themselves as being 'liable' (notwithstanding technical 'operational control'). This would permit firms in a more complex 'emissions' based relationship to determine the appropriate liability point on a commercial basis.

› Further consultation will be required in respect of firms being deemed to have liability for the emissions activity of downstream customers – e.g. gas retailers. In essence, reporting and adopting liability for such customers will have operational and system implications that need to be appropriately addressed.

› The documentation and reporting requirements should be those under NGERS – i.e. There should not be a replication of, or variation to, the NGERs requirements in the CPRS, rather the CPRS should reference those in NGERs. Further consultation with business is required to ensure that documentation and reporting requirements under NGERs will be adequate for the requirements of the CPRS assurance regime.

› While AGL recognises the benefits to the broader operation of the CPRS of an independent third party assurance of annual emissions reports of large emitters, AGL does not believe it is appropriate for there to be a 'blanket' requirement for such an assurance process. The policy needs to recognise the significant cost this will impose on liable parties in circumstances where firms will already be incurring a raft of new compliance costs (including the cost of acquiring permits). AGL suggests a risk-based approach for auditing of emissions reporting directed by the Regulator (as proposed under NGER) be applied to reporting after submission. This approach would provide the flexibility to direct assurance activities at the material sources of emissions covered under the scheme, while balancing the need to have accurate data in the market with minimising compliance costs on scheme participants.

› AGL does not support any 'naming and shaming' of non-compliant firms under the CPRS. This provides information on the individual trading positions of companies and can lead to distortions in trading activities.

6. Linking the Scheme to the International Market

AGL agrees that in order to ensure Australia achieves its emission reduction target in the most cost-effective way, linkage with an effective global market is necessary. AGL has been a firm advocate of international linkages, permitting Australian industry to access least cost abatement measures in achieving a global response to climate change. The CPRS should be structured so as to permit full international linkage in the future.

However, AGL agrees that participation in a fully linked international market would create significant risk to Australian industry in the first few years of the CPRS, and that this participation will be most effective if Australian industry is permitted a transition phase – whereby the CPRS is introduced, a largely domestic carbon market developed and stabilised, and then opened to full international linking.

AGL believes that the approach advocated in the Green Paper achieves the appropriate balance between protecting the early stability of the domestic carbon market, while permitting sufficient flexibility through access to the Kyoto Protocol's flexibility mechanisms (e.g. CDM/JI). AGL supports the ongoing review of international linkage mechanisms, and encourages the Government to adhere to a structured time frame in determining the ongoing linking arrangements as currently suggested in the Green Paper.

7. Auctioning of Australian Carbon Pollution Permits

Auctioning vs Allocation of Permits

AGL is very supportive of the approach to auctioning outlined in the Green Paper. AGL agrees that as the CPRS matures and the special circumstances of Emissions Intensive Trade Exposed (EITE) industries and strongly affected industries are adequately catered for, the CPRS should move to be predicated on the full auction of all permits. The auctioning of permits provides the necessary price discovery and encourages allocative efficiency.

A number of design principles should be considered when determining the appropriate mix of free permit allocation and auctioning. These are:

› Investment recognition: Investments made before the introduction of the emissions trading scheme should not be unfairly disadvantaged;

› Revenue: Where auctioning is used to distribute permits, the revenue raised should not be used for general Government purposes. The money should be allocated for emission reduction projects developed by industry and/or consumers;

› Early action: Some industry participants have altered production processes to reduce their emissions intensity. Action taken before the implementation of the emissions trading scheme should be taken into account by the scheme administrators.

› New Entrants: If an emissions trading scheme is to be successful, new entrants (with lower emission intensities) will be required. A free allocation process to existing generators would not disadvantage these new entrants.

› Investment Certainty: The permit allocation process should provide long term certainty for industry participants.

A relatively small proportion of free allocation for strongly affected industries and EITEs is the appropriate policy response to ensure businesses, including coal fired electricity generators, are compensated for economic losses associated with the changing regulatory environment.

Payment for Permits

AGL believes it is essential for the long term viability of coal fired generators, and the energy industry as a whole, that the Government allow firms with large emissions liabilities under the CPRS access to flexible auction settlement arrangements. AGL does not believe it can be considered rational or in alignment with the stated objectives of the scheme to require large emitters to pay for the all auction permits at the time of purchase.

AGL notes in this respect that:

› Generators and retailers operate under strict risk management policies that would require them to cover their future liability to a certain level. Both retailers and generators will therefore have to acquire both current year AEUs and future vintage AEUs to comply with existing risk management policies;

- AGL anticipates that the introduction of the CPRS will lead to significant increases in the prudential requirements generators and retailers have with NEMMCO – as the pool price increases and/or becomes more volatile, the prudential requirements will increase.
- On the basis of AGL's experience in the energy market, AGL would expect generators with significant emissions liabilities will face increasing levels of difficulty in sourcing the necessary cash to cover their current and future levels of liability from their own resources. Furthermore, they will face increasing difficulty sourcing reasonably priced credit from financial markets. This will lead towards shorter contracting terms and less liquidity in forward markets, thereby creating greater uncertainty for end-use customers.
- If liable entities such as generators are not provided with extended payment terms at auction settlement, they may need to rely more heavily on trading intermediaries to manage their cash flow and liability appropriately. Reliance on these intermediaries will undoubtedly increase the cost to these liable entities of meeting their obligations. These liable firms will then seek to pass these costs on to retailers and ultimately consumers.
- The impacts on energy retailers will be two fold:
  - retailers will need to acquire permits on behalf of the downstream gas customers; and
  - any financial stress experienced by generators presents a significant risk of leading to market volatility, which increases wholesale energy costs, which impacts on retailers and on consumers.

Because of the unique cashflow issues likely to be experienced by liable parties, AGL believes that delayed settlement should be an option for these parties only. The liable party would be required to hold permits purchased at auction under deferred settlement in a special account which can only be accessed when payment is finalised. This would ensure the Government is not taking on unnecessary credit risk.

Auction Design Features

AGL supports the structure of the auction schedule suggested in the Green Paper whereby there is an auction of permits for a relevant year both before, during and after the relevant vintage year. However, AGL has the following comments:

- AGL supports an ascending clock auction process. AGL believes this is necessary to ensure parties can appropriately manage their liability and position. A sealed bid process will not permit the requisite degree of transparency and flexibility that will be required.
- Proxy bidding will be a necessary feature of any sophisticated bidding process and should be facilitated in the auction support platform.
- AGL requires clarity in respect of the auction of future vintages. This should be by way of simultaneous ascending auctions. The text of the Green Paper suggests that there would only be one auction of future year vintages in a compliance year, while the diagram at Box 7.6 on page 269 suggests that there would be an auction of future year vintages at each auction of current year vintages.
- AGL supports an auction schedule for future years whereby permits for the 5 future years (i.e. the years for which the emissions cap is set) are available at every auction. AGL does not see any benefit to limiting the auction of future year vintages to once a year;

- AGL supports quarterly or monthly auctions. Such regularity of auctions would achieve a balance between providing liable entities with sufficient flexibility in managing their risk, while avoiding the issues that the Green Paper has indicated might arise from weekly auctions.

AGL considers the development of an internet based auction platform as a necessary condition of a successful auction process. It will be essential that stakeholders are closely involved in the development of this platform, and AGL suggests consultative workshops on this issue should commence as soon as possible.

8. Household Assistance Measures

AGL strongly supports the Government's policy of ensuring all auction revenue is used to assist Australian consumers, being households and businesses, adjust to the CPRS. AGL suggests there are two primary areas of focus:

- Assistance through the provision of access to energy efficiency initiatives; and
- Assistance by way of direct, transparent financial assistance to customers in financial hardship.

Nationally Consistent Energy Efficiency Schemes

AGL supports cost effective policies designed to increase uptake of cost effective energy conservation. AGL views energy efficiency policies as being appropriate for overcoming the barriers to the uptake of economic measures for reducing energy consumption. AGL supports the development of policies targeted at overcoming institutional barriers preventing allocative economic efficiency.

AGL strongly advocates the development of a national position on energy efficiency, with all jurisdictions agreeing to align their own policies, legislation and regulation with that national position. It is essential that the Federal Government move to staunch the flow of jurisdictionally based schemes.

AGL believes a national energy efficiency scheme should be based on:

- A central energy efficiency fund being developed through the revenue accumulated through the auction of CPRS permits; and
- Organisations then having the opportunity to access the funding by developing and delivering on business plans which deliver quantifiable energy savings. For example, the proved energy savings delivered by the specific activity could create 'certificates' which are then sold to the fund.

In this way, organisations are encouraged to pursue the least cost method of securing energy savings while having assured access to dedicated funding.

Direct Government Funded Financial Support of Low Income Consumers

AGL believes it is appropriate for some of the proceeds of the auction of emission permits to be provided for the financial support of customers disproportionately impacted by the increase in energy costs. AGL has long recognised that sectors of our community experience financial hardship, and that such hardship can lead to difficulties in maintaining access to essential goods and services, including energy. AGL currently provides assistance to customers in hardship which extend well beyond its regulatory obligations, and will continue to do so. However, it must be recognised that as the impact of the CPRS and its complementary policies becomes more pronounced, governments, retailers and community groups will come under increased pressure to address issues associated with financial hardship and access to energy.

AGL, and indeed energy retailers as an industry, advocate a 'shared responsibility' approach to financial hardship, whereby governments, retailers and community groups share responsibility for ensuring customers in hardship maintain access to energy. The energy industry has promoted a model whereby retailers support customers in temporary hardship through reasonable, extended payment plans, and where customers do not have the financial resources to meet these extended payment plans, governments are responsible for the payment of direct and transparent financial assistance. Community groups should not be responsible for the provision of financial support, but should assist and facilitate access to these support programs.

Education Campaigns

AGL also views education campaigns as an important tool in managing the impact – both from the perspective of informing people as to the likely impact, the reasons for the increase and the promotion of energy efficient practices to assist people in managing the impact. AGL suggests that governments and retailers should be engaged in joint initiatives, with funding for such an education program being provided by governments via the revenue from the auctioning of permits.

9. Assistance to Emission Intensive Trade Exposed Industry

AGL agrees that trade exposed industries may be disproportionately disadvantaged where they are competing with nations which have not yet transitioned to a carbon constrained environment. AGL supports in principle the provision of assistance to these EITEIs.

AGL notes that in determining the assistance to be provided to EITEI for 'indirect' electricity emissions, the Green Paper currently contemplates the calculation of an 'energy factor', which would attribute a value to the difference between the cost of electricity under the CPRS and the cost of electricity in the absence of a CPRS. AGL notes that this calculation may have some relevance to regulatory pricing processes, and requests inclusion in any future consultation on this point.

10. Strongly Affected Industries

AGL firmly supports the provision of support to strongly affected industries. As noted in previous sections, AGL believes that a relatively small proportion of free allocation is the appropriate policy response to ensure that Australian business is provided with sufficient certainty in respect of sunk investments in Australia's future energy requirements.

AGL believes that the approach suggested by the Green Paper offers a robust basis on which to formulate the appropriate measure and means of compensation. Specifically, AGL is of the view that:

- Direct assistance should be provided in the form of free permits. In this way, the permits act as a 'hedge' on the value of carbon thereby mitigating any risk of carbon price volatility and any subsequent change in the value of compensation required;
- Direct assistance should be determined and delivered prior to the commencement of the scheme. While AGL accepts this presents the Government with some practical difficulties, it is essential for the energy industry to have security in respect of their financial position and prudential requirements. As such, AGL supports upfront assistance;
- The Government's allocation suggestion is appropriate as it provides a simple, transparent and reasonably accurate method of determining the reduction in asset value associated with the introduction of the CPRS. Specifically, the following process is supported:
  - Determining first the quantum of permits to be allocated to the coal fired generation industry;
  - Dividing that pool on the basis of fuel type (ie whether fuelled by black or brown coal); and
  - Allocating the number of permits to each facility within that fuel type on the basis of NEM registered capacity.

While many commentators have argued that generators have had several years to 'prepare for a carbon constrained future', AGL notes that the proposed CPRS is the first climate change related emissions trading scheme which has not included large volumes of free permit allocation upfront. As such, it is reasonable to assume that that generators and other market participants have been preparing for a carbon constrained future based upon the accepted policies developed in other jurisdictions (e.g. Europe and NSW GGAS).

AGL supports the Government's intention to continue to work closely with all stakeholders in this allocation process.

11. Tax and Accounting Issues

AGL supports the establishment of specific legislation to cover taxation of carbon permits on the grounds that such legislation will increase certainty. This legislation should provide that:

- Income and deductions should be able to occur in the same period;
- The cost of acquiring a permit would be deductible at the time the permit is acquired:
  - If the permit is banked, the deduction would be deferred until the time the permit is surrendered or sold; and
  - Any proceeds received on the sale of a permit would be treated as assessable income.
- If free permits are issued, taxing those permits at the time of issue would exacerbate the cash flow impacts that liable firms will face (see above in relation to auction design). On this basis, free permits should be recognised as income at the earlier of:
  - When they are sold; or
  - When they reach their vintage year.

12. Transitional Issues

Managing Retail Pricing Impacts

As recognised in the Green Paper, the introduction of an CPRS will impact on the retail price of gas and electricity paid by Australian consumers. There will be two primary 'drivers' of this impact on retailers and consumers:

› The increase in the electricity pool price and contract price, and the wholesale gas price to account for the price of carbon, and

› The 'compliance' costs imposed on retailers for small gas customers under the CPRS Retailers will also be subject to compliance costs associated with liabilities under other regulatory schemes, such as the expanded MRET, energy efficiency and buy back schemes.

AGL is very concerned to ensure that retailers are permitted to fully pass through the costs associated with the introduction of the CPRS and complementary policies. It is imperative for the viability of the Australian energy industry that retailers are not required to absorb carbon costs. The costs that will be incurred by retailers are such that any fettering of the ability to achieve full cost pass through would pose a significant risk to their ongoing financial viability. Further, the policy rationale on which the CPRS is predicated is that carbon must be priced into the cost of energy to send the appropriate price signals to the community. It should therefore be the primary objective of all governments, federal and jurisdictional, to ensure full cost pass through to consumers, with appropriate assistance being provided to consumers through direct and transparent rebates rather through control of retail prices.

Retailers potentially face two impediments to the pass through of carbon costs:

› The regulation of retail prices by jurisdictional authorities, who will seek to impose regulated pricing on a future basis at a time when it will be extremely difficult to asses the impact of carbon on retail pricing; and

› Restrictions imposed in contracts that preclude the pass through, due to the fact they were entered into a time prior to the commencement of the CPRS by 2010 being contemplated.

Regulation of Retail Prices

Retail prices are the subject of regulation in most jurisdictions. As a consequence, retailers are exposed to a very high degree of risk that regulators will not account for and permit full cost pass through. AGL perceives this 'regulatory risk' to be very high in circumstances where:

› Retailers will be incurring a significant escalation in costs, a number of which will be upfront costs that have serious implications on retailer cash flow;

› The price of carbon will not be known at the time when regulators are attempting to establish the methodologies and price paths prior to the commencement of the CPRS, and it will be exceedingly difficult to predict the carbon price prior to the CPRS commencing;

› The Federal government is establishing the CPRS policy framework, while jurisdictional governments and regulators control regulated energy pricing policy; and

› Regulators and governments will be concerned to ensure customers experience a smooth transition to an ETS based economy, and will therefore wish to provide a stable trajectory to energy pricing rather than permitting a real time pass through of cost.

AGL firmly believes that the retention of price regulation will not only present a risk for retailers, but in fact represents a significant risk to the successful implementation of the CPRS. The removal of price regulation will lead to more flexible, cost-reflective tariffs, improved price signals to consumers, resulting in greater energy efficiency and demand side management.

AGL notes that the Green Paper currently proposes the determination of an ‘Energy Factor’ in assessing the assistance to be provided to EITEIs. The Energy Factor will be required to calculate the difference between the energy costs those EITEIs would have incurred in the absence of the CPRS so as to assess the competitive disadvantage faced by those firms. AGL suggests this concept has relevance to the regulation of retail price, and requests that energy retailers be included in any consultations on the determination of this Energy Factor. AGL will take the opportunity to discuss this further with the Government in the following months.

Contractual Restrictions

AGL suggests the Government should consider a legislative mechanism which permits the pass through of carbon related costs notwithstanding contractual provisions, subject to further consultation around the specific drafting of such a clause.

13. Governance Arrangements and Implementation

AGL supports the general governance structure suggested in the Green Paper, whereby: the Government is responsible for developing the relevant policy and enshrining that policy in legislation and regulation; and then an independent regulator is responsible for giving effect to and enforcing that legislation and regulation. AGL advocates a clear delineation between policy and legislative responsibility and administrative responsibility, which sits most appropriately with an independent regulator.

However, AGL does believe it is imperative that there are clear and stated objectives which the regulator is directed to be given effect to in the administration of its responsibilities. This is particularly important in respect of issues such as the determination of compensation and assistance, where the quantum of assistance provided by the regulator is key to ensuring the policy objective of the Government is achieved.

AGL believes that the Government should seek to expedite the establishment of the scheme regulator. AGL notes that under the proposed scheme, the regulator will have a number of responsibilities which should be completed well prior to the commencement of the scheme, including:

› Determination of issues of compensation and assistance to strongly affected industry and EITEIs; and

› Consultations with stakeholders on a number of issues that will pertain to the effective, practical administration of the scheme, particularly in respect of auction design.