

October 11, 2002

Secretary
Senate ECITA References Committee
Parliament House
Canberra ACT 2600

ecita.sen@aph.gov.au

Re: Inquiry into The Renewable Energy (Electricity) Amendment Bill 2002

Dear Secretary

Thank you for the opportunity to provide this submission to the above inquiry. The Australian Business Council for Sustainable Energy (BCSE) represents the interests of Australia's sustainable energy industry. We have more than 250 organisations as members and were recently formed through the merger of the Australian EcoGeneration Association (AEA) and the Sustainable Energy Industries Association (SEIA)

The BCSE has been very supportive of the legislation this Bill seeks to amend. However, there are a number of serious unintended consequences, which will mean the measure is not going to achieve what was intended. The three major problems relate to:

- Flaws in the baseline setting process for old large-scale hydro projects, which will see more than a \$1 billion of ordinary Australian's money being misdirected;
- A lack of transparency in the baseline setting process, which is inhibiting an informed market for renewable energy; and
- Anti-gaming provisions proposed in the Amendment Bill, which actually penalise existing generators for normal operating practices rather than addressing the legitimate issue of gaming.

Below we outline amendments to the Act that will address the above shortcomings. These are not policy changes but rather work to make sure that the Act works effectively and fixes up unintended consequences.

1. Addressing flaws in the baseline setting process

The major problem with the Mandated Renewable Energy Target (MRET) relates to the way baselines have been determined for existing large-scale hydro projects. This is seriously undermining the effectiveness of MRET to deliver new investment in renewable energy projects, as was one of its main intentions.

This problem was revealed by the BCSE (formerly the Australian EcoGeneration Association) when it undertook a comprehensive analysis of the measure and the new renewable energy projects it was likely to create.

The conservative assessment (attached) shows ordinary electricity customers will pay more than \$1 billion and receive no greenhouse abatement or additional renewable energy. The BCSE has gone through this report in detail with Environment Minister the Hon Dr David Kemp and indicated to him that because of the conservative approach taken this figure could be closer to \$1.5 billion.

If all the RECs that could be produced by existing old large-scale hydro projects were produced then no new renewable projects are needed until at least 2008. This assessment is not disputed.

It is important to stress that these RECs can be created without producing additional renewable energy. The BCSE understands that the legislation was always meant to provide an incentive for old hydro projects to improve their performance. Unfortunately, the manner in which the baselines have been set means that more than 28.5 million RECs representing over \$1 billion will be created without generating any additional renewable energy and without requiring any new investment or any changes in operating practices. This was never intended by the legislation and means that the equivalent of 500MW of new renewable projects will be kept out of the market. If this unintended consequence is not fixed Australia will lose the jobs, investment and industry development associated with these projects.

This unfortunate position is creating problems for proponents of new renewable projects. The uncertainty surrounding the market means that retailers are baulking at entering power purchase agreements that are required to underpin new projects. Without these agreements new projects will simply not happen. Unfortunately, not many new projects have been committed this year lending support to this position. The BCSE has as its members the developers of these projects and as such has a very good understanding of the difficulty project developers are having because of this problem.

The BCSE understands that a review of MRET is scheduled for 2003 that relates to policy issues. The baseline problem does not relate to policy changes but simply ensuring the measure delivers what it was promised to deliver. Amendments to the current Bill could be made to address the issue within the current policy setting. The changes need to:

a) Ensure that RECs are only earned for additional generation

For generators in excess of 20MW (38 plants) RECs should only be produced when cumulative renewable production is above the cumulative baseline. This ensures that only "additional" renewable generation would qualify for RECs. This effectively means that generators must hand back RECs they have produced because of being over their baseline if in a subsequent year they produce less than their baseline. A generator would not be expected to surrender more RECs than they have produced. Similarly, where a plant or system failure leads to significantly lower output, then they would not have to surrender RECs.

For example, a generator produces the equivalent of 100 RECs over its baseline in the first year. If in the next year it produces the equivalent of 80 RECs below its baseline, it would then have to hand back 80 RECs. If instead it produced the equivalent of 120 RECs below its baseline in the second year then it would have to hand back 100 RECs. The year after it would have to produce at least 20 RECs above its baseline before it could generate new RECs. What this means is cumulative production over the life of the measure is used rather than on a yearly basis. This is consistent with a baseline that is averaged over many years.

b) Address anomalies with generators with storage

For those generating plants with significant storage facilities (only 2 plants), the baseline should reflect the average plant capacity rather than the historical average. The current

approach used of averaging output over 14 years to remove hydrological variability does not make sense where significant storage is used to manage output from year to year.

For these generators the baseline needs to be their long run average generation capacity. This figure is already determined and represents the output the generator could produce if it used all the water it had available in any year to generate power rather than to store for future years. Therefore it is appropriate that it should only create RECs when it produces more power than its average capacity, rather than some historical averaged figure, as is the case now.

2. Transparency in baselines

Baselines for existing renewable power projects that seek to create RECs should be made publicly available. Given the significant benefits that accrue to these generators, there is no case why this information should not be released. The public has a right to know where its money is going.

Furthermore, all efficient traded markets rely on appropriate information disclosure to avoid prospects of market gaming and potential insider trading. Without such transparency, there is a very real prospect that the embryonic trading market for RECs will fail. A robustly traded REC market with liquidity will be essential if the MRET measure is to operate effectively.

3. Address anomalies in the anti-gaming provisions

The BCSE is also concerned with the manner in which the anti-gaming provisions in the Amendment Bill have been proposed. Interestingly, the need for anti-gaming provisions arises due to the anomalies in the establishment of baselines for generators that were commissioned prior to 1 January 1997. If the amendments proposed by the BCSE above are implemented, there is no need for the “anti gaming” provisions in Section 30D (6).

a) Uncertainty created for the sugar industry

The drafting of Clause 30D (6), which devolves the responsibility for defining and applying gaming to the Regulator, creates considerable risk and uncertainty for some renewable industry sectors. It is particularly the case for the sugar industry, where a number of sugar mills operate in a local area. It is important that the definition of gaming be clarified in the legislation and not to be left to the Regulator as by doing so has the potential to put at risk future investment in renewable cogeneration in the sugar industry.

Cane transfers between sugar mills (which are also renewable generators) are a normal operating practice. The practice is likely to increase over the coming years as the industry restructures to optimise operations and reduce costs to compete internationally. Under the proposed changes this has the potential to be defined as gaming.

Clause 30D(6), if retained should be more explicit with the following proposed changes:

A gaming arrangement is an arrangement to co-ordinate the amount of electricity generated by each power station in the group during the year using the relevant supply ~~in order~~ when the predominant outcome is to allow more certificates to be created ~~in respect of~~ without an increase in the total electricity generated by the power stations in the group during the year using that supply than would otherwise be able to be created.

b) Gaming between periods

The “anti gaming” provisions as currently drafted in the Amendment Bill only deal with generators that share the same fuel source and manage their operations to increase the amount of RECs produced without a corresponding increase in renewable generation.

The provisions fail to account for the position where generators that have access to fuel storage can manage the amount of their annual production so as to substantially increase the amount of RECs produced over a number of years without increasing the amount of renewable energy produced. In the case of large-scale hydro, this could amount to more than 5 million RECs worth approximately \$175 million over the life of the program.

This is a significant issue and can be addressed by the changes we propose in section 1 above.

c) Gaming of market and price

The anti-gaming provisions covered under the Amendments relate to the situation where an accredited generator can produce RECs without actually increasing the production of renewable energy. The BCSE believes that other gaming concerns arise due to the manner in which baselines have been determined for old large-scale hydro projects.

Specifically, there is a concentration in the supply (or potential supply) of RECs within the market in the early years. Owners of old large-scale hydro plant have the ability to produce significantly more RECs than required to meet the target, so that new generation is not actually required until 2008. This is outlined in detail in the attached report. The manner in which these RECs are released onto the market has the potential to substantially lessen competition. This is a critical issue in the early years of the scheme where the target is very low.

The market is also in an embryonic stage and we believe that there is a clear case for the anti-gaming provisions to be expanded to include not just the gaming of production but also the gaming of the price and market for RECs. With this in mind, the conditions under which a generator loses its accreditation should be extended to include the situation where the generator is using its market power to affect the price of RECs to lessen competition.

The BCSE welcomes the opportunity to expand on this submission and the attached reports, and provide any further information you may require. We are also available to appear at any hearings should the Committee think it appropriate.

We trust this committee can simply address the above shortcomings in the legislation as tabled so that the measure achieves what was intended.

Yours sincerely

Original signed

Ric Brazzale
Executive Director