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The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

By Email: economics.sen@aph.gov.au

Carbon Pollution Reduction Scheme Bills 2009

The Energy Supply Association of Australia, National Generators Forum and Energy Retailers Association of Australia appreciate the opportunity to provide collaborative comment and feedback to the Senate Standing Committee on Economics regarding the Carbon Pollution Reduction Scheme Bills 2009 (the CPRS Bills).

Australia's energy supply industry comprises over $120 billion in assets, employs 49,000 people and contributes $14.5 billion directly to the nation's Gross Domestic Product. Secure, reliable and competitively priced energy is essential to the effective functioning of all aspects of modern economies.

The Energy Industry supports the development of a reliable and sustainable energy supply system, where greenhouse gas emissions reductions are achieved at least-cost through rational policy settings and measures that are national, long term and complementary to competitive market arrangements. This objective is most effectively achieved by implementing an efficient economy-wide national emissions trading scheme (ETS) as the primary emissions reduction policy. Climate change measures beyond an ETS must be demonstrably complementary and result in cost beneficial outcomes.

The Energy Industry currently produces approximately 35% of Australia's greenhouse gas emissions and will be significantly impacted by the introduction of an ETS. The Energy Industry considers that the implementation of a well designed national 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-medium term. Failure to ensure an orderly transition could have widespread and potentially long lasting adverse economic impacts.

The Carbon Pollution Reduction Scheme (CPRS) as proposed in the Bills tabled in Parliament on 14 May 2009, significantly risks an orderly economic transition. There are a number of critical issues with the CPRS proposal on both matters of policy and legislative drafting, and the Energy Industry's support for the CPRS is conditional on these being addressed. This submission firstly addresses the enduring issues with the current policy. It then considers the impacts of the "new measures" announced by the Government on 4 May 2009 on the CPRS Bills, and finally, setting aside policy concerns, the submission provides direct comment and feedback on the legislative provisions of the CPRS Bills as tabled.

Critical issues with the current Carbon Pollution Reduction Scheme design

There are four critical issues that are not adequately addressed in the Federal Government's current CPRS design. To ensure the security of supply and investor confidence in long-lived, capital-intensive assets, the CPRS needs to:

- Adequately address the stranding of coal-fired generation assets. A measured transition to full auctioning (as proposed in most other schemes to date) would enable a greater volume of permits to be administratively allocated to affected generators to ensure there is no disproportionate loss of economic value on the sector's balance sheets.

- Commit to ten years of firm scheme caps followed by a ten-year rolling gateway.

- Manage the working capital requirements for liable entities from the operation of the CPRS including taxation and auctioning.

- Ensure retail price regulation is removed. Efficient prices are necessary to provide the appropriate signals for new investment and without full cost pass-through the viability of retailers and the entire energy supply industry is at risk.

The Energy Industry supports the development and implementation of a well designed ETS. However, the Energy Industry cannot support the CPRS unless these four issues are adequately addressed.

A measured transition to full auctioning

Rationale for initially providing administratively allocated permits to coal-fired generators

The environmental integrity of an ETS is not dependent on bankrupting generators. Australia's coal-fired generation assets have design lives which are measured in decades and were built at a time when there was no cost on greenhouse gas emissions and no clear prospect of when or how such a cost might be introduced. The clear beneficiaries of investments in coal-fired generation were households, businesses and large industrial producers who paid considerably less for their energy use (second lowest in OECD countries) – the owners of the coal-fired assets have operated in a competitive market making only normal returns on their investment. Had there been a clear path for greenhouse policy, energy sector investors may have deferred or stopped investment in existing infrastructure and accelerated investment in different lower emission technologies. Both would have increased the cost of electricity.

An ETS is simply a mechanism for trading the right to emit greenhouse gases up to a specified cap. The environmental integrity of the scheme comes from the choice of cap – not how the initial permits are allocated. However, the CPRS makes a set of choices designed to adversely impact existing coal-fired generators by requiring them to purchase almost all of their emissions from the scheme's commencement and the

Government using that revenue to ‘compensate’ households, businesses and large industrial producers who have historically benefited from the low electricity prices afforded by coal-fired generation.

Not all of the cost of the permits will be borne by electricity generators and some of it will be passed on to consumers. However, to the extent that cost pass-through is not possible and it results in the write-down of electricity generation assets, this should be recognised through the administrative allocation of permits. The administrative allocation of permits will not subsidise coal-fired generators and keep them in production any longer than necessary – once new, more competitive, lower emission technologies are constructed these coal-fired assets will begin to cease production. However, the administrative allocation of permits will help to ensure that these coal-fired generation assets remain in service until the transition to lower emission technologies can be made and allow new technology to develop. It will also give new investors in the energy supply sector the confidence that when the Government institutes major policy change, that has the potential to strand material long-life infrastructure assets, then the value of these assets will be recognised.

The administrative allocation of an insufficient number of permits to coal-fired generation assets in the transition to the CPRS could have serious implications for the short-term viability of the electricity markets due to the financial distress of a significant number of generators. Impairing the balance sheets of coal-fired generation assets will also send a poor signal to future investors about the Government’s willingness to make substantial policy change and strand electricity sector assets in the process.

The requirement to purchase 87% of the sector’s current emissions from the first year of the CPRS is likely to result in an immediate reduction in generators’ credit ratings and/or breaches of financial ratios (due to the immediate loss in asset value). At the very least, a number of generators would be unable to meet the prudential requirements of their Australian Financial Services Licence and would be unable to trade, increasing the likelihood of electricity price volatility.

The current global financial crisis is also having a direct and immediate impact on the financial positions of a number of existing energy market participants and the Government’s assumption that there will be a ready supply of potential investors and/or debt and credit providers to take over these distressed assets is heroic. Private-sector operators have reported difficulty in re-financing existing investments and obtaining finance for new projects. A number of participants are operating under financial arrangements that do not provide for a large shift in operating costs associated with purchasing permits and do not have access to sufficient credit lines (see Box 1).

Box 1: Impact of the global financial crisis

esaa recently surveyed its member companies to assess the impact of the global financial crisis on the energy supply industry. Key results from the survey show that:

- Australian energy businesses face a total refinancing obligation over the next five years of more than $50 billion (this represents more than one-third of the existing asset base).
- Generation businesses account for about $19 billion of total refinancing with some $8.5

billion due for renewal in 2011-12.

- Private sector participants account for about 78% of total generator refinancing.
- Approximately 45% of private participants reported a debt obligation to international banks.
- Capital expenditure in the generation sector over the next 5 years is estimated at between $17-19 billion.
- An addition $26 billion will be required over the next 5 years to purchase emission permits.

esaa members were also asked to comment on how the global financial crisis was impacting their business. Common concerns were:

- International banks have withdrawn from the Australian market or are reluctant to issue new debt. Energy companies are competing with other sectors of the economy for project funding.
- Risk margins and credit spreads have increased substantially – in the order of 200-350 basis points.
- Debt providers are reducing their exposure and requiring equity providers to take more risk at the same time that equity holders have incurred significant losses in asset value.
- Banks are placing more onerous covenants and restrictions on any refinancing.
- The tenor of debt renewals has shortened to 2 or 3 years.
- There is more due diligence on existing and new project financing resulting in delays in financing all transactions.
- The Government's decision to guarantee debt in the banking sector and that of state governments has constrained liquidity for sectors that do not benefit from the guarantee.

For many of those generators the introduction of the CPRS, compounded by the impact of the global financial crisis, could trigger a revision by financiers and/or result in the suspension of payment under hedge contracts as the generators would be unlikely to meet any requests for additional credit support (due to the large working capital impost of the CPRS). This may result in a series of financial defaults throughout the market. These events could significantly undermine investor confidence in energy markets and result in a reduced number of potential investors in the Australian energy sector for future developments, including low emission plants. Higher hurdle rates would apply to any new investments that did occur due to increased risk premiums. This would in turn increase retail energy prices.

Uncertainty has an important effect on investment decisions particularly when these decisions cannot be reversed, or only at great cost. In this context, it is useful to distinguish between uncertainty and risk. Risk can normally be managed through mitigation measures but uncertainty presents a more serious informational problem, because it implies that the distribution of fundamental parameters determining the value of an investment is largely unknown. In the presence of uncertainty, investors worry that their investment could be stranded and will tend to factor in the option of waiting for new information before making investment decisions. While uncertainty is a fact of life for investors, there are particular features of climate change policy that make investment uncertainty a significant problem of significant scale.

The CPRS will fundamentally change the risk profile of electricity investments. The financial success of electricity investments will be highly dependent on the form and operation of rules and regulations of the scheme, which will be subject to change over time. In particular, there is likely to be significant and ongoing uncertainty over future targets and abatement pathways.

From an investment perspective, shifts in fundamental scheme parameters imply shifts in the price of carbon, and hence shifts in the returns across various types of investments. Confidence in the likely direction of the regulatory arrangements is important for industries such as electricity where investment in assets is lumpy, and requires significant lead-time. This means even short periods of uncertainty can have significant effects on investment outcomes.

It has been observed that the Australian energy sector is already being viewed by international investors as riskier than many other countries. Given the scale of future investment required this should be a major concern to the Australian government.

The provision of administratively allocated permits can mitigate these effects. It is a demonstration by government that it recognises that policy changes can cause shocks to investors and is a commitment to minimising the detrimental effects of uncertainty resulting from policy changes that are outside the control of investors. In providing administratively allocated permits, the Government effectively imposes an opportunity cost on itself when it comes to making significant changes to scheme parameters. This in turn can encourage the Government to make any changes in an orderly way and with sufficient advance notice.

In addition, unless it is assumed that there is a substantial pipeline of new producers and projects that will come on line relatively quickly, the delivery of the abatement objective is in part contingent on the decisions made by current asset holders. If these asset holders suffer substantial asset stranding, their investment decisions will be affected. The provision of administratively allocated permits will help to give existing asset holders confidence that their new investments are not likely to be subject to stranding risk. Finally, if existing asset holders are financially distressed, the provision of administratively allocated permits can help to minimise the impact such distress has on future investment decisions. Investors are concerned that if the Government can make a radical regulatory change once, it may do it again in say 10-15 years time, when even new-build assets may have only operated for one third of their design life.

The CPRS White Paper makes reference to the notion of foreseeable regulatory change and the view that investors should have taken account of carbon price risk in the discount rate applied to new investments.

Many of the existing coal-fired generators currently supplying the bulk of electricity in Australia were built and commissioned more than two decades ago. For more recent investments and acquisitions, investors have had no empirical basis to make an assessment of carbon price risk as there has been no detail or information on the timing, form or level of a carbon impost. It is only in the last two or three years that the industry has seen actual detail on a possible national approach to emissions trading. As the Green Paper recognises, it was not until June 2007 that there was bipartisan support at the national level for a broad-based ETS. Importantly, all of the national schemes that have been canvassed in recent years by state and federal governments have accepted the need for offsetting asset value losses through administratively allocated permits to high emission plant adversely impacted by the introduction of a price on emissions.

Insufficient administratively allocated permits to coal-fired generators

In the first ten years of the CPRS, electricity generators will be required to surrender around 2 billion emission permits at a cost of $55 billion (real). The White Paper proposes to administratively allocate only 130.7 million permits to coal-fired generators with the remaining almost 1.9 billion to be purchased. This translates to only 13% of the sector's emissions for the first five years of the scheme in comparison to the 100% allocation of permits in the early years of the European Union's scheme. Under the American Clean Energy and Security Act of 2009 (Waxman-Markey Bill) as currently proposed, merchant coal-fired generators would receive around 50% allocation for eighteen years.

However, the Energy Industry has never argued for a 100% administrative allocation of permits to coal-fired generators.

The administrative allocation should reflect any loss of asset value, over and above the average loss in asset value experienced by the rest of the economy, from the introduction of an ETS. The proposed administrative allocation of 130.7 million permits is insufficient and considerably lower than the consensus of Government modelling results which suggest at least 500 million permits (or 50% of the sector's emissions) should be administratively allocated over the first five years of the scheme to prevent the impairment of the generation sector's balance sheets. However, it should also be noted that for most coal-fired generators, the loss in asset value will extend well into the second decade of the CPRS and these losses were completely ignored in the Government's modelling.

To inform the decision on the required number of administratively allocated permits, the Government commissioned three separate models to assess the likely impacts on asset value that the CPRS may have on the sector. Over the first decade of the CPRS, MMA concluded that the asset value loss for coal-fired electricity generators was $2.3 billion, while ROAM Consulting and ACIL Tasman reported losses of $9.4 billion and $10.5 billion respectively.

The latter two estimates of asset value loss are broadly consistent with the ACIL Tasman study for esaa and with the first 10 years of losses under a CRA International study undertaken for the National Generators' Forum. Interestingly, MMA's previous modelling for the National Emissions Trading Taskforce had asset value losses much higher than $10 billion and considerably higher than its $2.3 billion estimate for the CPRS.

It is therefore surprising that, in the face of multiple, broadly consistent pieces of quantitative analysis, the Government determined that less than $3.5 billion worth of administratively allocated permits would be sufficient to mitigate the negative impacts of financially distressed generators and to secure investor confidence in the energy market. A key factor in the Government's decision to only allocate 130.7 million permits seems to have been "competing Budget priorities" but ultimately it will be the market that will determine whether this is sufficient and, if it proves to be insufficient, the impact on the energy sector and the broader economy could be extremely costly.

Tenure and timing of announcement of Scheme caps and gateways

With a measured transition to full auctioning that provides a sufficient administrative allocation of permits to coal-fired generators, an ETS is the best mechanism for pricing greenhouse gas emissions and ensuring investor confidence in the energy sector. However, investor confidence in the energy sector is dependent on the ability to confidently determine a clear view of future greenhouse gas emission prices. To date, this has not been possible, but the introduction of the CPRS was intended to rectify this.

However, the Government's decision to only commit to five years of firm scheme caps is disappointing. The Energy Industry recognises that the setting of scheme caps and gateways requires a balance between the criteria of economic efficiency and policy flexibility to allow the Government to respond to changes in scientific knowledge and international commitments. However, the proposed timeframes for the scheme caps and gateways do not appropriately balance certainty and flexibility.

The Government proposes to provide a 15-year window of scheme caps and gateways, declining to 10 before being extended to 15 once again. This is an inadequate timeframe for planning long-lived, capital intensive investments. The Energy Industry considers that at a minimum, annual scheme caps should be set for a 10-year period that is extended by one year, each year. The proposition of a 10-year gateway is supported as it then makes for an effective 20-year view of scheme caps and gateways. However, rather than allowing the gateway to contract to five years before the next gateway announcement, the gateways should also be extended by one year, each year.

The Government is the only entity that can commit Australia in international negotiations and, therefore, the Government should bear the risk of future scheme caps and/or gateways being inappropriate. If the Government enters an international agreement that requires it to reduce emissions below the scheme caps or gateways, it should purchase the required abatement on the international market.

Additional working capital requirements

The current CPRS proposal will impose significant new working capital requirements on liable entities. As depicted below, this imposition is a consequence of the approach to auctioning and the taxation of permits.

Auction design

The Energy Industry is supportive of moving towards 100 per cent auctioning of permits after a sufficient administrative allocation of permits has been made. As the largest liable sector, an auction design that is efficient in price discovery; manages the significant working capital requirements of liable entities; and assists parties to meet their obligation at least-cost is of considerable importance.

Full auctioning will require generators to purchase and surrender approximately 200 million permits annually. In addition, generators will also need to purchase ahead to support forward contracts. With an indicative national emissions target range of between 5 and 25% below 2000 level emissions at 2020, generators will need to hold permits well in excess of $10 billion – more than $4 billion worth of permits to comply with the CPRS and more than $6 billion worth of permits to support forward electricity contracting. This will significantly increase working capital requirements and exacerbate costs to meet prudential requirements.

The joint industry submission to the CPRS Green Paper argued that to manage this, auctions should be held regularly and for a stream of future years. The Government has recognised this issue and the White Paper and legislation commit to monthly auctions compared to the quarterly auctions proposed in the Green Paper.

In addition, the joint industry submission argued that flexible settlement terms should be available to enable better management of reduced cash flows and to reduce the need for additional credit support. The Government also recognised this concern in the White Paper and has commenced consultation on deferred payment arrangements. However, the Energy Industry considers that the deferred payment facility put forward for discussion by the Department of Climate Change in its April 2009 discussion paper was inadequate in addressing these issues. The Energy Industry considers that a deferred payment facility for both current and future vintages is critical to manage working capital requirements and assist forward contracting in the electricity market.

Currently there is a considerable lack of forward contracts being written in the electricity wholesale markets, owing to both the uncertainty over scheme caps and the subsequent inability to hedge carbon prices.

Prior to the EU ETS commencing, forward contracts in the electricity wholesale markets were continuing to be written for periods after the Scheme commenced. Market participants could continue to confidently take positions in the market because the vast majority of their permits were administratively allocated. In fact, in the EU only 3-7% of permits will have been auctioned until 2012 with the rest administratively allocated.

It is noted that in a number of EU countries with a heavy reliance on coal-fired generation, administratively allocated permits will remain until 2020. In contrast, the Australian market does not have such assurances and any commitment to auction AEUs in early 2010 does little to address the current problem. At this stage, it would appear that both the working capital requirements and limited availability of permits will not support the level of forward contracting that has been the practice in the NEM over the last 10 years. This will create increased risks – particularly for retailers and their customers.

Taxation

A significant concern for the Energy Industry is that the implementation of the taxation amendments will result in the need for additional working capital. In particular, the application of GST to permit transactions and the upfront taxation of administratively allocated permits, will significantly exacerbate working capital requirements and compromise the Government's stated design objectives of simplicity, efficiency and equity.

The joint industry submission to the CPRS Green Paper, along with many industry bodies, did not support the application of normal GST rules to CPRS emissions permit transactions. This was on the basis that it would give rise to significant additional financing and compliance costs and create distortions in both the domestic market and overseas transactions.

While the Energy Industry supports the intent of the legislation that GST will not apply to administratively allocated permits, the application to normal emissions permit transactions will give rise to significant short-term cash flow implications. One estimate is that the 'imposition of GST would affect business cash flow by about $50,000 to $100,000 a year for 1 million tonnes worth of emissions permits[1].

The Energy Industry considers that the Government's proposed GST treatment does not meet the criteria of simplicity. A preferred approach of affording emissions permits GST-free status would achieve this aim, avoiding the current unnecessary complexity as well as significantly reducing compliance costs.

The Energy 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 CPRS and could potentially introduce distortions to secondary markets if significant volumes of administratively allocated permits are sold.

Further issues arise for entities with Substituted Accounting Periods (year end 31 December) who are eligible to receive administratively allocated permits. Surrendering emissions permits early will decrease the asset base onto which Thin Capitalisation provisions are applied and potentially increase the level of permanent interest deductions denied.

The Energy Industry is also highly concerned with the divergent tax treatment of administratively allocated permits for Emissions Intensive Trade Exposed Entities (EITE). EITE's 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 any timing disadvantages. This will result in an inequitable treatment between EITEs receiving administratively allocated permits and Strongly Affected Industries (SAI), exposing such entities to substantial working capital disadvantages relative to EITE's. The Energy Industry in its response to the Green Paper called for a similar treatment to that currently proposed for EITE's to apply to SAI's and strongly supports greater consistency in the tax treatment of any assistance between the two groups.

Finally, the Energy Industry considers that the purpose of administratively allocating permits is to address the long-term reduction in underlying asset value. The

[1] "GST To Apply on Permits" – The Australian Financial Review – 11 March 2009 Pg 9

imposition of a tax will serve to reduce the level of compensation and therefore should be factored into the setting of the overall quantum of assistance.

Cost transparency

The Energy Industry has long supported the removal of retail price regulation where competition is demonstrably effective. A study undertaken for esaa by CRA International into the effect of retail price regulation found that price regulation in contestable retail energy markets is likely to confer little or no public benefit but impose considerable direct and indirect costs, thus reducing overall welfare .

For the CPRS to operate efficiently and provide least-cost emission reductions, consumers should be exposed to the cost implications of greenhouse gas emissions. The retention of regulated price caps creates the real risk that retailers may be prevented from passing on higher wholesale energy and network related costs and increased prudential costs associated with the CPRS in a timely manner. This could force retailers to experience significant losses and be 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.

The Federal Government has acknowledged in the CPRS White Paper that ideally there should be no regulatory impediments to the timely pass-through of reasonable costs, to ensure the objectives of the CPRS are not undermined. The White Paper goes on to recognise that competition and consumer choice are the best ways to achieve cost-effective demand-side participation in energy markets. However, it concludes that the best way to progress cost pass-through is to support the work of the Ministerial Council on Energy (MCE). The MCE agreed at its meeting on 12 December 2008 to propose to the Council of Australian Governments that the Australian Energy Market Agreement (AEMA) be amended to specify that, where retail prices are regulated, energy cost increases associated with the CPRS shall be passed through to end-use customers.

The Energy Industry has concerns as to the effectiveness of the proposed approach to facilitating appropriate and timely cost pass-through for retailers. The Energy Industry considers that the introduction of the CPRS and the imposition of other climate change measures will make the already difficult task of setting cost-reflective retail prices for those customers eligible for ‘standard’ or ‘default’ tariff offers substantially more complex. The AEMC concluded in its Interim Report for the Review of Energy Market Frameworks in light of Climate Change Policy that “we do not consider that the current retail price regulation arrangements are sufficiently flexible to be able to cope with the potentially large and rapid changes in retailer costs”.

Designing a regulatory regime that can set retail prices in advance based on forecasts of likely forward wholesale prices, network charges and retail costs and margins is an inherently difficult task. The Energy Industry considers that retail prices set by open and competitive retail markets provides retailers with the greatest flexibility to pass-through such costs and provide end use customers with appropriate signals to engage in cost effective energy efficiency and demand-side management activity.

Where governments are unwilling to commit to reform, there should 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.

The CPRS Bills

The following provides commentary on the key concerns that the Energy Industry has identified in the CPRS Bill and associated Bills. In support to this commentary, Attachment A provides specific clause by clause detail on the issues raised below, and other items identified by the Energy Industry.

Unless otherwise specified, a reference to a section below is referring to the main CPRS Bill.

National scheme gateways

The provisions for setting the *National scheme gateway* under s15 represent a significant departure from the policy positions offered in the White Paper. The intention to provide up to 10 years of gateways beyond the minimum five years of scheme caps (policy position 10.3) is not reflected, nor is the approach to extending the gateways by five years every fifth year from 2010-11 (policy position 10.6).

The Energy Industry considers that s15 should be amended to provide greater compulsion for the Minister to take steps to ensure regulations for gateways are passed at the same time as regulations for the scheme caps, and that the tenure of the gateways is at least 10 years initially. The Energy Industry considers that the gateways should be extended by one year, every year, to maintain a 10 year gateway horizon.

Liable entities

Under Part 3 of the Bill, CPRS liability is imposed on the controlling entity rather than the entity with operational control. This aligns with default reporting obligations under the National Greenhouse and Energy Reporting System (NGERS).

The Energy Industry, in closely examining the implications of the above, has concluded there is potential for significant contract risks to arise that may prevent the pass through of CPRS-related costs. As partially acknowledged in the Parliamentary Secretary for Climate Change’s second reading speech, the proposed liability transfer mechanism may not sufficiently address this transitional issue.

Obligation transfer number

The obligation transfer number (OTN) mechanism under Part 3 has been established to account for emissive supplies and determine liability. Appreciating that such a mechanism will always encounter difficulties in application, it would appear that the design may be oversimplified, and may not accommodate the potential structures of commercial entities and corresponding taxation. Given the use of NGERS as the basis for reporting and liability, greater clarity is required on the interaction between NGERS and the OTN, particularly where incorrect OTNs are quoted in the course of a compliance year.

In addition, the Energy Industry wishes to highlight the following items with respect to the OTN mechanism:

- The application process should be refined (s43). Information requests may be onerous and without clarity on the process, the current sanctions appear imbalanced given the open-ended nature of the section.

- The issue of an OTN by the Authority's own initiative (s45) should be contestable by the recipient. This section currently does not provide for consultation or an appeal process in circumstances where the Authority considers an entity should have an OTN.

- The potential implications for counterparties that the surrender or cancellation of an OTN represents are significant. Contractually, suppliers, or other parties, could be "caught out" if the Authority accepts the surrender, or cancels an OTN (ss 46&47). It is recommended that a due process of notice and consultation is provided to ensure effected parties are aware of a proposed surrender or cancellation.

The Energy Industry considers that further testing of the OTN application is required, to ensure that it is adaptive to the numerous corporate structures that are prevalent in the covered sectors.

Liability transfer certificate

Part 3, Division 6, Subdivisions A and B, provide for the liability to be transferred from one entity to another on a voluntary basis. According to the bill's explanatory memorandum (par 1.254), the liability transfer certificate (LTC) is: *" intended to allow the triggering of a change of law or carbon cost pass through clause in a contract that the subsidiary is a party to on the basis that such clauses would not be triggered if liability was placed on the controlling corporation"*.

The application of a particular change in law clause in an agreement will very much depend on the scope of that clause. However, the clause will often refer to the change in costs as "arising as a result of" the change in law. In its submission on the draft legislation to the Department of Climate Change, the Energy Industry highlighted that advice had suggested that owing to the voluntary nature of the liability assumption (ss70(2) & 74(2)), it is unlikely to trigger a typical change of law clause in a contract.

As noted in the Parliamentary Secretary for Climate Change's second reading speech, consultation with industry to resolve this issue is continuing. The Energy Industry considers there are significant commercial risks for liable entities should an effective means to impose liability on the appropriate entity not be resolved.

Surrender of eligible emissions permits

In what is regarded as a significant deviation from CPRS White Paper policy, s129(6A) of the Bill prohibits the use of eligible international emissions permits for the compliance year beginning 1 July 2011. This section was not in the draft legislation and presumably has been included as part of the $10 fixed price commencement. The Energy Industry considers that this provision should be removed, as it is a distinct contradiction to the objects of the CPRS as provided for in s3(c) of taking action towards emissions reductions in a “flexible and cost-effective way”.

Fixed price commencement and the Electricity Sector Adjustment Scheme

The Government announced a series of new measures for the CPRS on 4 May 2009. Of particular significance was the one year delay of market trading of the CPRS and the fixed price transition period.

Under s89 of the tabled CPRS Bill, the Authority now has the power to issue permits for a fixed charge of $10 for the period 1 July 2011 to 15 December 2012. Furthermore, s89(5) provides that immediately after a permit is issued at a fixed price, the person receiving the permit is taken to have surrendered it. As such, the Energy Industry considers that the first year of the CPRS will effectively operate as a tax on greenhouse gas emissions at a rate of $10 per tonne.

However, the manner in which this new measure has been introduced into the CPRS Bills has further compromised the policy intent of the Electricity Sector Adjustment Scheme (ESAS), as originally outlined in Part 9 of the Bill.

Under s176(2)(a) the administrative allocation of permits will commence in the year beginning 1 July 2011 – the $10 fixed price commencement year. However, administratively allocated permits will not be eligible for surrender for any years after this first year (s129(5A)) and will be cancelled at the end of 15 December 2012 (s103A) if the holder does not request the Authority buy them back at a value of less than $10 (s103B). As such, the option value of administratively allocated permits and the flexibility for recipients to use the administratively allocated permits in a manner that provides highest value has been eroded.

The Energy Industry’s preferred approach is that the CPRS Bills be amended to allow permits allocated under Part 9 to be bankable and therefore acceptable for surrender in future years. This would give all administratively allocated permits a market value, as committed to in the White Paper and draft legislation, by making the permits fully fungible with future vintage permits.

Windfall gains test

Under s185 a person must make a submission with respect to the windfall gains test (outlined in s187) and set out their opinion as to why the generation asset either passes or fails the test. The form and content of this submission is to be determined by legislative instrument. A breach of s185 results in withholding the final two years of assistance. Presumably it is the Authority who would determine if this section has been breached, but is not clear against what measure the decision would be made. Furthermore, given the significant implications of a breach, the Energy Industry considers that s185 must be listed as a reviewable decision under s346.

Once an acceptable submission is made under s185, the Authority is empowered under s186 to either make, or refuse to make a *windfall gain declaration*. In making a decision with respect to a declaration, the Authority is given broad scope to make assumptions and estimates it considers reasonable, and must consult the Australian Energy Regulator (AER), the Australian Energy Market Commission (AEMC) or the relevant market operator. The construction of this consultation appears to allow for the Authority to make a declaration, regardless of whether a generation asset passed or failed the windfall gain test.

The Energy Industry considers the provisions under s186 require the following amendments to clarify this administrative decision:

- The declaration of a windfall gain should be limited to the outcome of the windfall gain test. The Authority should be empowered to make a declaration, subject to the windfall gain test being passed, given the Authority's role in establishing the test in s187.

- The timing and process for publishing a draft declaration should be prescribed. It is currently not clear if the Authority must consult other bodies, including the AER, AEMC or other relevant market operator, before or after it has made a draft declaration. The legislation should state at what point such bodies are to be consulted and explicitly confine their input to advisory only.

- At least 90 days should be specified in the legislation as the minimum period for submissions to be made with respect to a draft declaration. While the inclusion of 30 days under s186(3A) is a welcome improvement on the draft Bill, it is considered insufficient for fulsome responses to a decision that has significant implications.

- The procedure for the Authority to conclude consultation on a draft declaration and finalise its decision is unclear. The Energy Industry considers that the affected person should be consulted both prior to the draft declaration, and prior to a final decision. Additionally, under s186(9), the Authority should be required to remove any material from a report that the affected person considers commercial-in-confidence.

In s187, the Authority sets out in a legislative instrument the parameters for a person to apply with in performing the windfall gains test. The draft Bill was silent on the specific consultation process for establishing the instrument. However, the tabled Bill now provides that the Authority must publish a draft of the instrument on its website (s187(10) and consider any submissions received within a timeframe that is no shorter than 30 days (s187 (11)). While this is a welcome amendment, the Energy Industry considers that the provision should specify a timeframe of no shorter than 90 days, to allow sufficient time for affected parties to respond.

Finally, the Energy Industry notes that the windfall gains test is only focused on determining if the level of assistance received for an eligible generation asset has exceeded the asset value loss. Conversely, there are no provisions which consider if the level of assistance has been inadequate. At a minimum, the Energy Industry considers that the assistance offered under Part 9 should be an explicit scope item for review under Part 25.

Power system reliability

The Energy Industry appreciates the intention of the *power system reliability test* is to engage the authoritative body that is best placed to determine if capacity withdrawal or cessation will compromise system reliability. However, the Energy Industry considers that the current Bill is ambiguous, providing little detail as to the process or basis for the market operator to make a decision.

It is noted that an amendment made to the draft legislation, reflected in the tabled Bill, now in effect imposes a 120 day time limit on the relevant market operator (ss189A and 189B). While this is a welcome addition, it does not address the ambiguity regarding the nature of the decision expected of the relevant market operator within 120 days of request.

The Energy Industry considers that Part 9, Division 5 should be amended to explicitly identify the making of regulations to establish the criteria and procedure for the market operator to conduct the reliability test. Including:

- Whether the test is in relation to the implications of that specific generation complex reducing capacity;
- How multiple applications will be assessed, given the threshold nature of impacts on reliability that capacity withdrawal or cessation may have; and
- Any other events that the operator is entitled to consider when determining the system reliability with and without the capacity in question.

The Energy Industry would welcome the opportunity to provide comment and feedback on appropriate regulations.

Finally, although legal advice has indicated that judicial review would be available to a windfall gain test outcome, given the significance of the test, the decision should also be subjectable to a merits review, under Part 24.

Self-incrimination

Sections 300 & 312 of the Bill prevent information obtained under the s95 information gathering powers from being used in civil or criminal actions against an individual, outside of certain civil and criminal actions relevant to the Act. These provisions have omitted to offer the same protections to a body corporate. This omission is considered a significant and concerning stray from the self-incrimination provisions under s155(7) of the *Trade Practices Act 1974* (TPA), which offer the same protections to a body corporate. The Energy Industry considers that ss300 & 312 should be amended to ensure the provisions as offered to individuals exist for corporate bodies also.

Information-gathering powers and monitoring powers

The Energy Industry does not support the powers proposed for the Authority in terms of information gathering (Part 17) and monitoring (Part 19). In both these instances the Authority may require disclosure or obtain a monitoring warrant for very broad reasons, such as seeking information relevant to the operation of the Act or substantiating information.

In particular, the Authority does not need to have a reasonable belief that breach or non-compliance has occurred. Legal advice has confirmed that the powers under Part 17 are broader than those under s28(1) of the *National Electricity Law*, which was previously not supported by industry.

The Energy Industry considers that the powers conferred under Part 17, and the basis for issuing a monitoring warrant under Part 19 should be contained to only those circumstances where the Authority has a reasonable belief that breach or non-compliance has occurred.

Review of decisions

The Energy Industry supports provisions for a merits review process under Part 24 of the CPRS Bill. However, the Energy Industry is concerned the Administrative Appeals Tribunal may not be the appropriate body to administer the review process. While it is understood the Government wished to avoid constituting a ‘new’ body for this purpose, given the unique matters the review body will consider and their potential importance on business viability, it is imperative to ensure that any review body is appropriately equipped to perform this function.

Authority’s disclosure capacity

Under s48 of the Australian Climate Change Regulatory Authority Bill, with the approval of the Chair of the Authority, otherwise protected information may be disclosed to a range of domestic and international agencies, bodies or persons. Given the proposed information-gathering powers in the main CPRS Bill (as addressed above), the Energy Industry is concerned by the broad capacity for the disclosure of potentially commercially sensitive information

The Energy Industry considers that the powers of the Authority for information disclosure needs to be restrained for the protection of commercially sensitive information. For example, developments in lower greenhouse gas emission technologies will be a key focus of a competitive international carbon market, the capacity for the Authority to disclose information may have significant commercial ramifications. It is recommended that this provision is amended to ensure that affected parties are consulted prior to the Chair granting approval for disclosure.

Taxation

As highlighted earlier, the introduction of the CPRS, coupled with the impact of the global financial crisis, will give rise to significant working capital issues which may threaten the viability of coal-fired generators. Setting aside these issues, the Energy Industry notes the following matters with respect to the draft taxation provisions in the Consequential Amendments Bill.

The Energy Industry supports the amendments introduced under the Consequential Amendments Bill under s420-51 to provide taxpayers with greater flexibility in choosing valuation methodologies. In addition, the Energy Industry also supports amendments under s420-21(2) that allow for a roll-over of cost for international permits held on revenue account that are transferred from a foreign registry to the Australian National Registry.

GST application

In Schedule 2, item 1, permits under the CPRS are defined as personal property rights for the purposes of GST. As stated earlier, the Energy Industry does not support the application of GST to AEUs and other eligible permits.

Further, it is not clear whether related products will constitute financial supply for GST purposes. Given the costs involved in managing a permit liability, many parties may rely heavily on the purchase of derivative products. It is suggested that further clarity is required as to whether such products constitute a financial supply for the purposes of GST and therefore would be input taxed.

The draft legislation clarifies that the import of overseas Kyoto permits will not be subject to GST. The Energy Supply Industry has obtained legal advice which indicates that this treatment could be a distorting factor in a taxpayers choice to hold a Kyoto permit over an AEU. Given the current and historically low prices for some overseas permits and the ability to import an unlimited quantity, the GST treatment could be a further factor in driving down demand for domestic permits and have a significant impact on expected revenue from initial permit auctions. In addition, the current treatment may prevent further harmonisation with overseas schemes such as New Zealand where a GST-free treatment has been adopted.

Same Business Test

The Energy Industry requests that further guidance is provided as to whether trading in permits constitutes the undertaking of a new business for the purposes of the Same Business Test. This does not appear to be addressed in the Consequential Amendments Bill.

Stamp duty

The Energy 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. The Energy Industry understands that all State and Territory Governments have responded to Treasury indicating that stamp duty will not be levied on permit transactions. The Energy Industry encourages the Government to provide public confirmation of this outcome in order to provide certainty to industry.

Transitioning of existing schemes

The Energy Industry notes that the CPRS Bill does not address the policy positions outlined in the White Paper on the transitioning of State and Territory schemes with similar objectives to the CPRS. The Energy Industry considers investments and contracts made in good faith under existing schemes to be transitioned or ended early should be fully compensated, on the basis of not penalising early movers.

The Bill should provide further clarity around a transition plan for current schemes and include principles for any compensation to be paid as a result of early termination. This will help to maintain certainty and confidence in the carbon markets leading up to the introduction of the CPRS. In the absence of specific announcements, the participants in these schemes, such as the Greenhouse Gas Reduction Scheme (GGAS), are left uncertain as to the timing for transition, and the treatment that investments will receive. The delay in the CPRS commencement, and the subsequent impact on the uncertainty of GGAS and the market for its certificates, exemplifies this problem.

Conclusion

The Energy Industry welcomes the opportunity to comment on the CPRS Bills as tabled on 14 May 2009. The Energy Industry supports the introduction of a well-designed emissions trading scheme, but considers the current CPRS design fails to address four critical issues. Unless the design provides for a smooth transition through an adequate administrative allocation of permits; delivers greater certainty on scheme caps and gateways; manages working capital requirements of liable entities and removes retail price regulation, the Energy Industry cannot support its passage.

The Energy Industry has also identified a number of other items in the CPRS Bills that need to be addressed to improve the clarity and certainty of the proposed legislation.

Yours sincerely

Brad Page
Chief Executive
esaa

Don Woodrow
Chair, Greenhouse
Working Group
NGF

Alastair Phillips
Acting Executive Director
ERAA

Attachment A

esaa, NGF and ERAA submission to the Senate Standing Committee on Economics on the Carbon Pollution Reduction Scheme Bills.
June 2009

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/ s**	**Clause/s**	**Energy Industry 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. It is recommended that the objects should also specifically include: - Imposing a cost on emissions, with this cost being borne by consumers so as to send the appropriate price signal and thereby drive behavioural change; and - offset asset value loss suffered under the Act.
1	-	3(4)c	A key aspect of the third object is to take action towards meeting various targets in a “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 CPRS. It is recommended that this statement is defined, and reflected in Part 25 – Independent reviews.
1	-	3(5)	Whilst Australia is currently supportive of the UNFCC approach to calculating emissions and emission concentrations, it is noted that this newly-inserted section appears to bind the calculation of future *National emission reductions targets* to, as yet unknown, international conventions.
1	-	5A & 6	The definitions with respect to *supply* and *when supply occurs* were largely left to regulations in the draft exposure bill. The delay in providing these definitions was considered undesirable, given the importance of such definitions for entities in the energy supply sector in determining the potential implications of the CPRS. The tabled CPRS Bill more clearly captures the basis for determining supply of an eligible upstream fuel, and when that supply occurs.
2	-	14	The *National scheme cap* tenure of 5 years is not supported. The scheme cap should have a continuous tenure of 10 years to provide adequate certainty for investment in capital intensive infrastructure.
2	-	15	The provisions to set the *National scheme gateway* do not capture the tenure of up to 10 years expressed in the White Paper (policy decision 10.3) or the extension of the gateway by 5 years, every fifth year (policy position 10.6). Stating that the “regulations may declare” upper and lower bounds, suggests that provision of gateways will be optional, and furthermore, the legislation does not specify the frequency of extending gateways, if any have been set. This section should be amended to ensure regulations are passed that implement the White Paper

Carbon Pollution Reduction Scheme Bill			
Part/s	Division/s	Clause/s	Energy Industry Comment
			policy and establish gateways for 10 years. Furthermore, it is considered that the gateways should be extended by 1 year, each year, to retain a 10 year gateway window.
3	-	17 & 18	The approach to determining the a liable entity for a facility follows the process established under NGERS. Relieving the entity who operates a facility of a liability because of overarching ownership may be undesirable for numerous reasons, including cost pass-through. It is recommended that the process for establishing liability is reviewed, as many issues, including the efficiency of the obligation transfer and the effectiveness of the liability transfer certificate, may stem from the current approach to allocating liability (see below).
3	-	-	The Obligation Transfer Number (OTN) mechanism has been designed to follow supply and determine where liability rests. Appreciating that such a mechanism will always encounter difficulties in application, it would appear that the design may be oversimplified, and not accommodating to the potential structures of commercial entities. It is recommended that further consultation is undertaken to test the OTN application, to ensure that it can adopt to numerous corporate structures that are prevalent in the covered sectors.
3	5	43	The powers to request further information with respect to an OTN application appear onerous and unchecked. Without knowledge of the actual time period and the level of information allowable to be requested, the sanctions for non-compliance (s 43(2)) are considered imbalanced given the open-ended nature of the clause.
3	5	45	There should be opportunity for a person to refuse or at least appeal an OTN that is issued by the Authority on its own initiative. Although the Authority may have undertaken the appropriate identification processes as per s 45(1b) there may be other factors that suggest the OTN is not required or appropriately allocated with that person such as contracting arrangements, or specific interpretation of financial control.
3	5	46	The process for surrendering an OTN is a far less defined process than the application for an OTN. It is requested that further clarity is provided over how the Authority will deem it is 'satisfied' by the prescribed criteria. The current section provides entities with little certainty around the processes that they may need to undertake to prove the surrender is valid. It is unclear whether the Regulations will provide guidance as to the steps required to satisfy the Authority that the surrender is satisfactory. Further, it is noted that the surrender of an OTN may have significant implications for upstream suppliers or other entities where liability may be ascribed. There should be an obligation on the Authority to notify effected parties, including an adequate notification period.
3	5	47	As per the concerns raised over the surrender of an OTN (s 46) there is a lack of clarity over what will satisfy the Authority that cancellation of an OTN is an appropriate course of action. Cancellation could cause significant implications for contracting parties, including the costs of supply and ultimately the surrender of permits for covered emissions. There should be an obligation on the Authority to notify effected parties or publicly announce an intention, together with an adequate notification period.

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Part/s	**Division/ s**	**Clause/s**	**Energy Industry Comment**
3	6	Subdivision A	It is noted that consultation on an appropriate mechanism for liability transfer to trigger change of law clauses and affect cost pass through is currently being undertaken by the Department of Climate Change. As highlighted in response to the draft legislation, advice suggests that the current voluntary nature of the liability transfer certificate (LTC) will be ineffective in triggering contractual change of law clauses. Resolution of this issue is of significant importance in the interests of the carbon price signal being effective and allowing liable entities to manage the costs of the CPRS. See also comments on ss 16-17 above regarding the default placement of liability.
3	6	Subdivision B	The financial control transfer of liability mechanism may face similar pass-through issues as those outlined in relation to Part 3, Division 6, Subdivision A. That is, if this is used to transfer liability to a different entity, that entity may find that existing contractual change of law clauses are not triggered to enable the pass through of carbon costs, due to the voluntary nature of assuming the liability.
4	2	-	The legislation does not appear to explicitly state that one AEU will represent one tonne of carbon dioxide equivalent.
4	2	103	The draft legislation prevented the Authority from determining the policies, procedures and rules for auctioning before 1 January 2012. It was considered that the inability to delegate this responsibility any earlier may be a barrier to a more responsive approach to auction rule making. The tabled CPRS Bill now delegates the responsibility of auctioning policy, procedures and rules to the Authority in the first instance.
4	2	103A & 103B	The provisions for cancellation or buyback of AEUs allocated under Part 9 for the year commencing 1 July 2011 is not supported. It is considered that AEUs allocated as assistance to the coal-fired electricity generation sector should be fully fungible with future vintages, to provide those owners of assets that suffer a significant decline in value, flexibility to utilise the assistance in a manner that delivers the most financial benefit. To make these AEUs not fungible with future vintages is tantamount to a departure from the White Paper commitment to provide assistance in the form permits (policy position 13.10).
4	3	112	Unlimited import of certain Kyoto units was a fundamental part of the White Paper CPRS design and should be accurately reflected in legislation. Allowing regulations to specify limits on import of Kyoto units could erode this key feature. (White Paper Policy Positions 11.5, 11.7 and 11.8). Whilst it is understood that the legislation has been drafted to allow for changes in Kyoto rules including a post Kyoto international agreement, it is suggested that the policy intent of allowing unlimited import of CER's (excluding temporary and long-term CER's), ERU's and RMU's, at least for the first three years of the scheme be specifically reflected in legislation.

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
4	3	113(1)	It is noted that the intent of White Paper (policy position 11.5) with respect to carry-over restrictions has not been reflected in the drafting. These restrictions for CER's (excluding temporary and short-term CER's) should be more definitive in the legislation, so as to rule out any future limitations on the carry-over of such CER's, that may represent a retraction on the policy intent in the White Paper.
4	4	122	The legislation should include a defined minimum period of notice for the inclusion of non-Kyoto international emissions units. White Paper Policy Position 11.5 states that generally, five years notice will be given.
5	-	126 & 127	The *amendment of assessments* provided for under these sections should adopt the timeframes and basis for amendment as specified in s 131. In particular, it is considered that the four year limitation imposed where there are no reasonable grounds for believing a person has provided a false or misleading statement, or engaged in fraudulent conduct, should be adopted.
6	2	129(5)(a)	The draft legislation withheld the ability to surrender current year vintages until after 31 October. This was considered undesirable as it limited the flexibility and management of a liability. The tabled CPRS Bill only partially addresses the inflexibility of the draft legislation, allowing for surrender once an emissions number for the previous financial year is published. It is considered that surrender of current year vintages should become permissible at the commencement of the relevant financial year.
6	2	129(5A)	Prohibiting the surrender of AEUs allocated in the first year of the CPRS in subsequent years is not supported. See ss103A & 103B above.
6	2	129(6A)	Prohibiting the surrender of eligible international emissions units for the financial year beginning 1 July 2011 is a departure from the White Paper policy positions 11.4 and 11.5 with respect to accepting Kyoto Protocol flexibility mechanisms from scheme commencement. Noting that in this first year of the scheme AEUs will be issued in unlimited numbers at $10, prohibiting the use of eligible international emissions units may result in imposing an abatement cost higher than it otherwise would be.
6	2	129(7)	The years in which eligible international units will be accepted is delegated to regulations. However, it is not clear whether such regulations will allow borrowing, as defined for AEUs in s 130(4).
6	3	130(4)(a)	The industry considers that the borrowing limit should be determined by the Authority, using clear rules-based provisions in the Act. Prescribing the limit in the Act removes a potentially important smoothing feature, and makes it difficult to adopt any recommendation that the independent review may make with respect to borrowing under Part 25.
6	4	141(2) & 141(3)	Among other functions the *Benchmark average auction price* will be engaged to determine the penalty for a unit shortfall for a particular compliance year. The definitions for *Total auction proceeds* and *proceeds of the last auction* suggest that the *Benchmark average auction price* could be partly determined by auction results of future vintages auctioned in the

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
			relevant financial year. It is considered to be inappropriate for a penalty to be partially determined by the auction price of an AEU that has been purchased in regard to future scheme caps. It is suggested that the definitions for *Total auction proceeds* and *proceeds of the last auction* be amended to specifically identify proceeds from the auction of AEUs with the same vintage as the relevant compliance year.
6	4	143	The treatment of permits surrendered in excess of a person's emissions number for a financial year is not supported. Retaining any excess surrendered permits presumes that the person will be liable in the following year, and furthermore, reduces the person's flexibility on how they chose to comply should they have a liability in the following year. It is considered that any excess permits surrendered should be reinstated to the person. If excess permits are retained by the Authority, it is not clear what will happen to these excess permits should the person who has right to account for the excess permits be subject to a merger, acquisition or a reduction in emissions to below the threshold level in a following year.
8	2		It is recommended that the legislation reflect the fundamental policy decisions set out in the White Paper for assistance to *Emissions-intensive, trade-exposed* industries, including the basis for determining eligibility, overarching methodologies and assistance rates (policy positions 12.6, 12.10 and 12.12).
8	3		It is considered the transparency of allocations under this provision could be increased. Unlike Part 9, where publication of individual eligibility for assistance is published (s180(6)), there is no requirement in Part 8 to publish eligibility of individual energy-intensive, trade exposed assistance recipients. It is recommended that information be published that identifies the number of permits allocated to each type of eligible activity. Such information would allow participants in the AEU market to make informed estimates as to how many permits allocated under the EITE program are likely to be directly surrendered, and how many will be sold into the market.
9	1	174	It is recommend that this objects clause be broadened to include an objective for the Authority to follow when exercising its decision making powers and discretions under this Part 9. Presently the onus remains entirely on the generator to justify its eligibility and ongoing receipt of permits (under the windfall gain and systems reliability test) with no requirement on the Authority to set out a statement of reasons to justify a refusal of eligibility or basis of windfall gain declaration. The objects clause should be expanded to require the Authority, in exercising its discretion and decision making power, to take account of the objects currently described, act reasonably in its requests for information, and provide justification and reasons for any decision which leads to an entity not receiving assistance under this Part.
9	2	176(2)&(6)	These provisions indicate that permits will be allocated on 1 September after the commencement of each eligible financial year, to the person who was liable at the end of the previous eligible financial year. It is recommended that permits are allocated prior to the commencement of the compliance year.

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Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
			Allocating permits earlier would provide greater certainty for liable entities, assist in the development of the AEU market, and promote liquidity in the wholesale electricity markets.
9	3	177(1), 177(8) & 178(1b)	In the draft legislation, the granting of ESAS permits required an application to be made, in a prescribed form and with required documentation, within 90 days from the commencement of the section. The prescribed form and required documentation were to be specified by the Authority and within a regulation. However, there was no specified date by which those regulations and specifications must be finalised. It was recommended that the 90 days commence from the latest of the passing of the regulations and the date of publication by the Authority of all requirements related to the application process under section 178. The tabled legislation has refined the eligibility certificate application process in two areas. Firstly, an application is now due within 180 days, which can be extended by the Authority. Secondly, the prescribed form and required documentation will now be specified by the Minister. Presumably this second amendment will reduce the risk of considerable time passing between commencement and specification of the application requirements for an eligibility certificate. It is recommended that at earliest convenience a working group is assembled with specific knowledge on how historical data collection compares with NGERS requirements and comprehension of existing reporting and verification processes, to ensure the Minister under s 178(1b) develops requirements that are appropriate and can be efficiently satisfied by applicants.
9	3	180(2), 182	In making its decision to issue an eligibility certificate and the annual assistance factor for each generator, there is no requirement that the Authority provide reasons / justification for: a) a refusal to issue a certificate; or b) a decision by the Authority in making "*the Authority's reasonable estimate of the number*" to depart from the emissions intensity or historical generation information which is submitted by the applicant. Given the technical nature of this data and its historical nature, any decision by the authority should be explained and justified in order to allow the applicant to interpret, and if necessary challenge such a decision.
9	4	-	It is noted that the windfall gain provisions are only triggered in circumstances where the Authority is satisfied that a generation asset is likely to incur a long-term net revenue gain, or the total value of assistance allocated exceeds the projected long-term revenue loss. Given the importance of Part 9 in assisting assets impacted by the CPRS, it is considered that there should be scope to address where assistance has been insufficient to satisfy the objects of Part 9. At a minimum, the assistance provided under Part 9 should be a scope item in the reviews outlined in Part 25.

Carbon Pollution Reduction Scheme Bill			
Part/s	Division/s	Clause/s	Energy Industry Comment
9	4	183	If a windfall gain declaration is in force in respect of a generation asset, the Minister has discretion to make, or not make, a determination that prevents the issue of Australian emissions units to that generation asset during the final two years for which coal-fired generation assistance is available. The Minister's decision is not a "reviewable decision" (i.e. it is not subject to merits review under Part 24) but it could be subject to judicial review assuming that relevant grounds can be made. Legal advice has recommended that a clause be inserted that explicitly states the Minister must consider a submission from the affected party (i.e. the recipient of permits) prior to making a determination. It is noted that any judicial review would likely test to see if the Minister had taken such a step However identification in the legislation would serve to ensure such a process was followed in the first instance.
9	4	185(2),(3),(4)	There is no information in the Bill concerning the form and content of the written submission required by the Authority as part of the windfall gain process. Recipients of permits, who breach this condition, will have their permits withheld for 2014-15 and 2015-16. Presumably it is the Authority who would determine if this section has been breached, but is not clear against what measure the decision would be made. Furthermore, it is noted that s185 is not listed as a reviewable decision. Given the implications of a decision that s185 has not been complied with, s185 should be listed in Part 24 as a reviewable decision.
9	4	186(3A)	The draft legislation did not specify that the Authority must allow a reasonable time period for people to make a submission to the Authority regarding a draft declaration published on its website. It was submitted that 90 days would be appropriate The tabled legislation stipulates that a draft declaration must be published for at least 30 days. It is considered that a 90 day duration would be more appropriate, to provide reasonable opportunity for an affected party to respond.
9	4	186(3)(c, d & da)	It is unclear what the intention of “consult” is with respect to the Australian Energy Regulator, Australian Energy Market Commission or appropriate energy market operator, and what weight (if any) would the consultation necessarily have in the Authority’s decision. Furthermore, it is not apparent whether these bodies are consulted before or after a draft declaration is published on its website. It is recommended that this provision is amended to comprehensively identify the nature of the consultation that the Authority must perform before making a draft declaration and a subsequent final decision with respect to the declaration. It is considered that an appropriate procedure would provide for two phases of consultation with the affected party; before the draft declaration and following the draft declaration. Furthermore, the weight of consultation with other bodies should be constrained to advisory only, to ensure the Authority retains the discretion for the decision.
9	4	186(4)(a)(b)	It is considered that the basis for the Authority to make a declaration will be depicted in s187, the windfall gain test. However the drafting of this provision may enable the Authority to expand on what it may consider, potentially resulting in the Authority making a windfall gain declaration irrespective of the outcome of the windfall gain test.

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
			Given the Authority's role in determining the parameters for the windfall gain test (under s187), any potential for the Authority to disregard the outcome of this test should be removed from s186.
9	4	186(9)	In response to the draft legislation, it was considered that recipients of AEUs must a have a right to veto any report with material they consider *commercial-in-confidence* before a version of the report is made available on the Authority's website. The tabled legislation only partially addresses this concern, providing that the affected party is to receive a copy of the report 14 days prior to publication or provision to the Minister.
9	4	187(10)&(11)	In the draft legislation it was noted that the method for calculating parameters was not prescribed in the and legal advice confirmed that the method was not subject to merits review (only the 'application' of that method is challengeable under Merits and Judicial Review). The method for calculating these parameters is critical to the windfall gain test outcomes. It was considered vitally important, to achieve the objectives of ESAS, that there be proper consultation and agreement on the method amongst recipients of permits in developing the legislative instrument. It was recommended that, *consultation* is expressly identified in the Bill (in addition to being referred to in the Legislative Instruments Act 2003). The tabled legislation provides for a consultation that prior to making an instrument with respect to the windfall gains test, a draft must be published and submissions invited for a time period of no less than 30 days. While this specific inclusion is a welcome addition, it is considered a timeframe for submissions of at least 90 days would be more appropriate.
9	5	189	Two key concerns were raised on the draft legislation regarding the manner in which this provision was drafted. It was suggested that the following matters should be considered in amending the draft legislation; • The apparent lack of criteria to guide the manner in which the 'appropriate energy market operator' will determine the question as to whether withdrawal or cessation is 'unlikely to be a breach of power system reliability standards'. It was suggested that such criteria need to be established, and that regulation is the most appropriate means of effecting this; and • The decision of the 'appropriate energy market operator' as to power system reliability was not a 'reviewable decision' under s346. Given the importance of such a decision, it was considered that this decision should be included in s 346 as a reviewable decision. Such regulations would need to clarify how the *appropriate energy market operator* determines the likeliness of a breach of the power system reliability standard over a 2 year period and whether the test must be in regard to reliability as impacted by that particular generation complex. The regulations would also specify a timeframe for the appropriate energy market operator to make a certification in writing. It

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
			was noted that this decision is an onerous requirement on the appropriate energy market operator and that the difficulty of such a decision could easily be compounded if multiple applications are submitted around or at the same time from generators. Sections 189A and 189B in the tabled legislation introduce a 120 day trigger with respect to certification or refusal to certify by the appropriate energy market operator. This time constraint is a welcome addition. However, the concerns of ambiguity with respect to the decision requirement and the administrative process for making the decision imposed on the appropriate energy market operator remain.
12	2	264	It is not clear that any information published under this section could only reasonably be published when the deadline for surrendering permits has passed for an eligible financial year. It may cause reputation harm if the Authority were publishing ‘expected’ shortfalls before participants were required to surrender permits. It is assumed that the section would only operate after 15 December in the next financial year (in respect of the previous financial year) but this should be made explicit.
16	-	293(7) and 294(7)	A significant holding is defined as 5% of permits of a particular vintage year, as a percentage of the national scheme cap for the vintage year. The policy intent of this provision is not clear, nor is the basis for choosing 5%. The industry notes that for some liable entities, they are likely to trigger a significant holding, purely by virtue of their liability under the scheme being greater than 5% of the scheme cap. Furthermore, given the flexibility in units acceptable for compliance, a 5% holding of AEUs could easily be dwarfed by a domestic holding of CERs. Of potential greater concern, is the concentration of the future vintage permit market. Given the small volumes that will be in circulation prior to the compliance year, it is conceivable that a percentage of permits auctioned may be held by relatively few entities. This issue is not specifically addressed.
17	-	296	The industry does not support empowerment of the Authority to require information or documents, simply in relation to the operation of the Act or associated provisions. Legal advice has advised that similar to s28(1) of the *National Electricity Law*, the powers conferred should be more exact and confined. It is proposed that the powers are confined to information or documents that are required by the Authority for the performance or exercise of its powers and functions, only in circumstances where the Authority has reasonable belief that breach has occurred.
17	-	300 and 312	It is noted that the provisions regarding *self-incrimination* prevent evidence generally from being admissible against an individual in civil and criminal proceedings except under certain aspects of the Act. These provisions significantly stray from those under s155(7)(b) of the *Trade Practices Act* 1974, which offers the same protection to a body corporate. These sections of the CPRS bill should be amended to adopt the provisions of the TPA with respect to self-incrimination.

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
19	6	321	The provisions for *Monitoring warrants* is based on it 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 wielding use of the monitoring powers.
21	-	337	This section does not actually reflect the terms in which s 296 stipulated. Section 296 does not suggest that any 'intention' is relevant. Further, any 'strict' civil liability for failure to provide documents or information is not considered appropriate. It is recommended that the provisions of the NEL which establish the circumstances in which a failure to produce documents and information does not invoke any liability are adopted. It is suggested that Division 3 of the NEL provides some appropriate precedent.
23	-	343(4)	It is recommended that the Authority's ability to cancel an undertaking should be subject to the consent of the relevant party(s).
24	-	-	The legislative provisions for a merits review is supported. However, there are concerns as to whether the AAT is the appropriate body. While it is understood that it was the intent of the government to avoid constituting a 'new' body for this purpose, it is considered that given the import of the matters the review body will consider, it is imperative to ensure that the review body is appropriately equipped to perform this function.
25			See note on Part 9, Division 4 above.
25	2	353(5)&(6)	It is noted that the periodic review process provides for a public consultation process, however there is no provision to require the Expert Advisory Committee to take into account the submissions made in the course of that consultation. Section 353(6) should be amended to state that the Expert Advisory Committee must also have regard to: - any submissions made; and - the cost and benefits of the policies being considered.
26	-	375	It is noted that similar provisions allowing for delegation by the Minister are contained in other Commonwealth Acts, for example the Corporations Act 2001 and the Migration Act 1958. Given the significance of a potential windfall gain determination and as noted in the commentary, the public policy nature of the determination, a clause should be included which prevents the Minister from delegating his or her functions under s183.

Consequential Amendments Bill			
Schedule	**Part/s**	**Item/s**	**Comment**
1	1	4	Defining AEUs and other eligible international units as financial products will require registration or amendments to existing Australia Financial Service Licences (AFSL). In addition, legal advice has advised that the classification may result in possible of insider trading allegations for business

Carbon Pollution Reduction Scheme Bill			
Part/s	Division/s	Clause/s	Energy Industry Comment
			conduct that would not otherwise be regarded as insider trading. Such situations include, where an emitter has confidential commercial plans to expand its operations and thus its emission-producing activities, so as to require a large increase in permits, that if such information were public, the price of permits would be materially higher. It is noted a consultation process to adjust the regulatory regime for financial products to accommodate AEUs and other units. However, it is considered that typically risk-averse liable entities are likely to incur new and additional compliance costs. As a general principle an entity seeking to comply with CPRS obligations in the normal course of business should not be subjected to new obligations such as applying for or varying an AFSL.
1	2	159	It is unclear why some scope 1 emissions are covered by the Act and why some are not. It is considered that the Act and not the regulations, should specify scope 1 coverage from the outset.
1	2	Part 3A, 22A(2)(c)	A report under this section states it must be submitted within 4 months after the end of the eligible financial year. Whilst it is appreciated that such a timeframe is considered reasonable in most instances, it should be noted that for suppliers of natural gas, final revisions to supply data can occur up to 6 months after supply. Requiring a report within 4 months, would result in data for the months of May and June being submitted that is subject to finalisation.
2	-	1	The application of GST to AEUs and other eligible units is not supported. This will increase the working capital requirements for liable entities and potentially distort overseas transactions. In the case of international units, legal advice obtained has indicated that where supply of eligible international units occurs outside of Australia, all other things equal, it will be acquired at a discount to the domestic price for the same international unit. Furthermore, it is currently unclear whether GST will apply to the supply of derivative products related to managing a permit liability.
2	-	Subdivision 420D	The FIFO provisions in the draft legislation were considered to be impractical given provisions in the main CPRS bill that allowed for emission units to be assigned unique identifiable numbers. It was considered the cost treatment of permits should be analogous to shares and allow taxpayers flexibility to choose FIFO or choose to pick individual units to surrender. The Energy Industry notes the tabled bill has addressed the concerns raised by providing for the use of three approaches: FIFO, the actual cost method or the market value method.
2	-	420-21	The proposed treatment in the draft legislation of international units was considered to highlight the difficulties of the FIFO provisions. This treatment would have resulted in the crystallisation of potential taxable gains and losses (on an unrealised basis) without an offsetting gain or loss in the tax year of the transfer onto the Australian register. This would have occurred where an entity was unable to choose to extinguish these units before year end due to having other units which it must extinguish first under the FIFO rules.

Carbon Pollution Reduction Scheme Bill			
Part/s	**Division/s**	**Clause/s**	**Energy Industry Comment**
			The tabled bill has addressed the issues raised by allowing for a roll-over of cost. Under s420-21(2) where an importing entity held the emissions unit on revenue account before importation, it is treated as having sold the unit to someone else for its cost just before it became a registered emissions unit. The entity is also treated as having immediately bought it back as a registered emissions unit for the same amount (the former cost).
2	-	420-55 and 420-57	The draft legislation provided for changing valuation methodologies only once in an initial five year transitional period. This was considered insufficient. It was suggested tax payers should be allocated greater flexibility to choose valuation methodologies, adopting a similar to the approach within existing trading stock provisions. The tabled bill does not limit changing methodologies to only once in a 5 year transitional period. After an choosing for the initial income year, a further change is possible during a transitional period of three years, and subsequently a choice can be made every fourth year following.
2	-	420-58	The proposed differential treatment of permits allocated under the EITE program and under Part 9 is not supported. If administratively allocated permits are subject to tax, there will be further cash flow implications for liable entities that potentially bias taxpayer decisions to acquit or sell rather than bank administratively allocated permits in order to avoid incurring an unfunded tax liability.

Australian Climate Change Regulatory Authority Bill			
Part/s	**Division/s**	**Clause/s**	**Comment**
3	-	48	The draft legislation provisions on disclosure were considered broad and could result in information disclosed to other domestic or international bodies without express permission. It was suggested this section be amended to ensure that individual information provided purely for the purposes of compliance with the scheme is not ultimately disclosed or used in a forum that may compromise an entity's reputation or commercial standing. The tabled legislation has partially addressed these concerns. Firstly, the disclosure to State, Territory and foreign government bodies is limited to those bodies whose functions include a function that corresponds to the function of the Authority. Secondly, a criminal offence is prescribed for a person (other than a foreign government) that breaches any conditions imposed by the Chair of the Authority with respect to information disclosed to that person. It is considered that a liable entity should have opportunity to veto the disclosure of information that may compromise an entity's reputation or commercial standing.

General comments
Same Business Test The Energy Industry requests that further guidance is provided as to whether trading in permits constitutes the undertaking of a new business for the purposes of the Same Business Test. This does not appear to be addressed in the draft legislation. *Stamp duty* The Energy 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. The Energy Industry understands that all State and Territory Governments have responded to Treasury indicating that stamp duty will not be levied on permit transaction and encourages the Commonwealth to provide public confirmation of this outcome.