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24 July 2009

Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

(*via e-mail to:* economics.sen@aph.gov.au)

Dear Mr Hawkins

RE: SENATE STANDING COMMITTEE ON ECONOMICS INQUIRY INTO *RENEWABLE ENERGY (ELECTRICITY) AMENDMENT BILL 2009* AND A RELATED BILL: APPEA COMMENTS

The Australian Petroleum Production & Exploration Association (APPEA) welcomes the opportunity to provide comments to the Committee's Inquiry into the *Renewable Energy (Electricity) Amendment Bill 2009* and a related Bill. APPEA has made submissions to a number of review processes in 2008 and 2009 commenting on the Expanded Renewable Energy Target (the Target), including to the Garnaut Climate Change Review, the Strategic Review of Climate Change Policies (the Wilkins Review), the COAG paper on *Design Options for the Expanded National Renewable Energy Target Scheme* and the Exposure Draft of the Bills.

APPEA is also a member of the Australian Industry Greenhouse Network (AIGN), a network of industry associations and individual businesses that contribute to the climate change policy debate and see value in joint industry action on climate change policy issues in order to promote sustainable industry development. APPEA has contributed to and supports the AIGN submission to the Inquiry.

A number of APPEA members have made individual submissions to you commenting on the issues under consideration by the Committee. APPEA commends these submissions to you.

If you have any queries on any of the issues raised in our submission, please feel free to contact Damian Dwyer, Director – Energy Markets & Climate Change via telephone on 6267 0902 or via e-mail at ddwyer@appea.com.au.

Yours sincerely

Belinda Robinson
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AUSTRALIAN PETROLEUM PRODUCTION & EXPLORATION ASSOCIATION LIMITED

SENATE STANDING COMMITTEE ON ECONOMICS

RENEWABLE ENERGY (ELECTRICITY) AMENDMENT BILL 2009 AND A RELATED BILL

APPEA Comments

JULY 2009

TABLE OF CONTENTS

1. INTRODUCTION

The Australian Petroleum Production & Exploration Association (APPEA) appreciates the opportunity to provide comment on the Committee's Inquiry into the *Renewable Energy (Electricity) Amendment Bill 2009* and a related Bill. APPEA has made submissions to a number of review processes in 2008 and 2009 commenting on the Expanded Renewable Energy Target (the Target), including to the Garnaut Climate Change Review[1], the Strategic Review of Climate Change Policies (the Wilkins Review)[2], the COAG paper on *Design Options for the Expanded National Renewable Energy Target Scheme*[3] and the Exposure Draft of the Bills[4] and would also refer you to those submissions.

APPEA is also a member of the Australian Industry Greenhouse Network (AIGN), a network of industry associations and individual businesses that contribute to the climate change policy debate and see value in joint industry action on climate change policy issues in order to promote sustainable industry development[5]. APPEA has contributed to and supports the AIGN submission to the Inquiry.

A number of APPEA members have made individual submissions to you commenting on the issues under consideration by the Committee. APPEA commends these submissions to you.

2. GENERAL COMMENTS ON THE EXPANDED MANDATORY RENEWABLE ENERGY TARGET

APPEA has previously noted its opposition to the Target, on the basis that:

- contrary to the assertions that '... *the RET is a complementary measure* ...'[6], the Target does not meet the *COAG Principles for Jurisdictions to Review and Streamline their Existing Climate Change Mitigation Measures*[7]. No 'other market failure' additional to that which is addressed by the proposed domestic emissions trading scheme has been identified by the Australian or State Governments;

- further, as the Treasury economic modelling conducted in 2008 shows[8], the Target achieves potential emission savings at around three times the cost of a domestic emissions trading scheme, thereby failing the 'least cost' requirement;

- the Target will 'crowd out' the adoption of economically efficient investment in new electricity generation capacity and innovative abatement reduction activities for the next twenty years, and defeat emissions trading as the 'heart' of emissions reduction in that sector; and

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[1] See www.garnautreview.org.au/index.htm for further information.
[2] See www.finance.gov.au/publications/strategic-reviews/index.html for further information.
[3] The APPEA submission is available at www.climatechange.gov.au/renewabletarget/consultation/pubs/012apia.pdf.
[4] See www.climatechange.gov.au/renewabletarget/consultation/index.html for further information.
[5] See www.aign.net.au for further information.
[6] COAG Working Group on Climate Change and Water (2009), *Treatment of electricity-intensive, trade-exposed industries under the expanded national Renewable Energy Target Scheme*, p. 7 (see www.climatechange.gov.au/renewabletarget/consultation/pubs/RATEconsultationpaper.pdf for further information).
[7] COAG (2008), *COAG Principles for Jurisdictions to Review and Streamline their Existing Climate Change Mitigation Measures* (see www.coag.gov.au/coag_meeting_outcomes/2008-11-29/docs/20081129_complementarity_principles.pdf for further information)
[8] Commonwealth of Australia, *Australia's Low Pollution Future*, October 2008 (see www.treasury.gov.au/lowpollutionfuture for further information).

- analysis by the Productivity Commission and economic modelling commissioned by the APPEA clearly demonstrate this flaw in the Target particularly with regard to inefficient under-investment in gas-fired electricity generation[9].

On the basis of the modeling completed for APPEA and the work of the Productivity Commission, the industry is of the view that the Government's objectives as set out in the Bill could be more efficiently met through other measures, such as a commercialisation fund, without adversely impacting on the integrity of the proposed emissions trading scheme.

As noted above, economic modelling commissioned by APPEA in 2007 showed that the combination of an emissions trading scheme with a 20 per cent renewable energy target is significantly less efficient than an emissions trading scheme in achieving a given level of emissions abatement.

In this context, APPEA highlights the assessment by Productivity Commission of the MRET, contained in their submission[10] to the Garnaut Climate Change Review, in which the Commission found:

> *An MRET operating in conjunction with an ETS would not encourage any additional abatement, but still impose additional administration and monitoring costs. To the extent that the MRET is binding (which is its purpose) it would constrain how emission reductions are achieved — electricity prices would be higher than otherwise and market coordination about the appropriate time to introduce low-emissions energy technologies would be overridden. If it was non-binding, it would simply increase administrative, compliance and monitoring costs. Moreover, it would also help to foster a perception that governments are amenable to interfering with the least cost abatement objective of the ETS. This could encourage other potential beneficiaries to seek special programs that neither increase abatement nor reduce its cost.*

In addition, in its Report, the Wilkins Review[11] similarly found:

> *While there are a variety of opinions on this matter, the Review considers that schemes such as the RET, FITs and demand driven subsidies for the deployment of solar power are not complementary to an ETS. They will, as discussed recently by the Productivity Commission, add to the cost of achieving an abatement target rather than producing additional abatement. The Review would concur with the Productivity Commission's analysis that the RET is likely to add to the cost of abatement, and would not be complementary.*

The *Renewable Energy (Electricity) Amendment Act 2009* as currently designed is not fuel neutral, excluding low emission sources of energy such as natural gas, and as noted by the Productivity Commission[12], will only benefit mature renewable energy technologies. The

[9] Productivity Commission (2998), *What Role for Policies to Supplement an Emissions Trading Scheme?*, Submission to the Garnaut Climate Change Review, May (available from www.pc.gov.au/__data/assets/pdf_file/0003/79716/garnaut.pdf) and CRA International (2007), *Implications of a 20 per cent renewable energy target for electricity generation*, November (available from www.appea.com.au/content/pdfs_docs_xls//NewsMedia/APPEAMediaReleases/attachment_2.pdf).
[10] Available at www.pc.gov.au/__data/assets/pdf_file/0003/79716/garnaut.pdf.
[11] Mr Roger Wilkins AO (2008), *Strategic Review of Australian Government Climate Change Programs*, 31 July, p. 141 (available at www.finance.gov.au/publications/strategic-reviews/docs/Chapter-Seven.pdf).
[12] Productivity Commission (2008), *What Role for Policies to Supplement an Emissions Trading Scheme?*, Productivity Commission Submission to the Garnaut Climate Change Review, May (available at www.pc.gov.au/__data/assets/pdf_file/0003/79716/garnaut.pdf).

most notable mature renewable energy technology is wind power and as noted in the Garnaut Review without large changes in transmission infrastructure 'new' technologies including wind will find it more difficult to compete. Unless market failures in transmission network extensions are addressed in concert with the Target, the number of eligible permits maybe too low to supply the market. At this point, the shortfall charge becomes the Renewable Energy Certificate (REC) price and the Target's cost to the economy.

Of even greater concern is the finding of the Garnaut Report[13] that notes:

> *… there is an interesting and seemingly perverse consequence of expanding MRET at the same time as the emissions trading scheme is to be implemented. Having both schemes operating side by side could see an increase in coal-fired power generation (by more than 2,000 MW) as gas-fired plants are crowded out by MRET. This would not occur if the emissions trading scheme were operating without MRET*.

This raises the prospect that the Target may in fact increase greenhouse gas emissions from the electricity sector.

As part of its desire to ensure that the greenhouse policy response to be developed and implemented in Australia in coming years, particularly the emissions trading scheme due to commence in 2010, achieves its greenhouse gas emissions abatement objectives at least cost to the Australian economy and society, APPEA has taken particular interest in the design of measures that seek to complement an emissions trading scheme.

With that in mind, APPEA in late 2007, commissioned economic consultants, CRA International (CRAI) to examine the costs associated with the proposal to adopt an expanded target of 20 per cent of electricity generation from renewable sources by 2020. A copy of the CRAI report can be found at **Attachment 1**.

In addition, APPEA believes least cost emissions reduction and practical action now involves encouraging the deployment of the low emissions technology that we do have, that is proven and capable of making the transition to a low emission energy future without major economic upheaval.

APPEA does acknowledge, however, that expanding the Target was a Government election commitment and that the Government intends to retain this policy measure.

3. SPECIFIC COMMENTS ON THE BILLS

Notwithstanding APPEA's fundamental concerns with the expanded target as both environmentally and economically inefficient, this section sets out APPEA's comments on the *Renewable Energy (Electricity) Amendment Bill 2009*, particularly as to how the design and implementation of the expanded target could seek to ameliorate to the extent possible its inherent inefficiencies and their associated costs to the Australian community.

[13] Professor R Garnaut (2008), *The Garnaut Climate Change Review: Final Report*, Cambridge University Press, Port Melbourne, p. 356 (available at www.garnautreview.org.au/pdf/Garnaut_Chapter14.pdf).

3.1 Eligible sources

The proposed coverage of the scheme must be as broad as possible in order to reduce the adverse impacts of the scheme on the forthcoming emission trading scheme.

With that in mind, APPEA notes the Bill does not propose to expand the range of eligible sources from the existing MRET scheme. One of the common criticisms of the renewable-based generators using, for example, wind and solar is that, on the margin, they cannot act in base load service and therefore require support from gas-fired generators. If one of the aims of the expanded Target is to make room for renewables in base load service, then an option is to consider amending the Target to provide opportunities for renewables proponents to enter into a commercial arrangement with a gas-fired generator to provide firm base load capacity.

Under such an approach the Bill could be amended to allow a combined renewables/gas-based project to provide base load power generation and be eligible to a proportion of a REC (say, 50 per cent) to recognise the synergies of such an approach in facilitating the entry of renewables into base load service.

3.2 Banking of Renewable Energy Certificates

APPEA supports the Bill's approach to allow banking of RECs to be permitted for the life of the scheme without restriction.

3.3 Compliance mechanisms – shortfall charge

Given the ambitious nature of the Target, the proposed compliance costs should be minimal in order to reflect the scheme's underlying policy failures. As noted in Garnaut Climate Change Review Final Report:

> *The expanded MRET will drive increasingly expensive options for the deployment of currently favoured technologies (for example, building wind farms in more remote areas) as well as the deployment of newer and more expensive technologies (such as geothermal and solar photovoltaic). This will lead to a higher renewable energy certificate price and higher electricity prices for consumers.* ***Conversely, the recent uplift in world energy prices (coal and gas) raises the average wholesale price of electricity and puts downward pressure on the certificate price***[14].

The recent reduction in world energy prices (coal and gas) may have the opposite effect to that noted above. Should the wholesale and REC prices diverge significantly and repeatedly trip the shortfall charge the schemes economic costs will potentially be higher than anticipated.

The Garnaut Climate Change Review Final Report[15] also notes that:

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[14] Professor R Garnaut (2008), *The Garnaut Climate Change Review: Final Report*, Cambridge University Press, Port Melbourne, p. 354 (available at www.garnautreview.org.au/pdf/Garnaut_Chapter14.pdf).

[15] Professor R Garnaut (2008), *The Garnaut Climate Change Review: Final Report*, Cambridge University Press, Port Melbourne, p. 355 (available at www.garnautreview.org.au/pdf/Garnaut_Chapter14.pdf).

… *maintaining the shortfall penalty would place an upper limit on MRET's higher costs relative to the emissions trading scheme, and on MRET's contribution to electricity prices.*

Given the Target's inherent design flaws the objective should be to subsume the Target into the forthcoming emission trading scheme as quickly as possible by applying a low shortfall price. With that in mind, APPEA notes the *Renewable Energy (Electricity) (Charge) Amendment Bill 2009* proposes to increase the shortfall charge from $40 to $65. APPEA recommends this amendment not proceed. Instead, from 2010, the Target penalty of $40/MWh, that acts to cap the subsidy and hence the inefficient cost of the Target, should be annually reduced by the $/MWh equivalent of the emissions trading permit price.

3.4 Scheme duration and phase-out

The proposed annual targets need to ensure that higher costs of electricity which will arise due to the restrictive characteristics of the scheme are minimised – that is, the annual targets should only be set to increase after a full review of the scheme in 2015, by which time there will be five years of experience as to how the Target has interacted with the emission trading scheme.

One of the key ways in which the costs inherent in the expanded target can be minimised is the phase the target out as soon as possible – ideally, by 2020.

As noted by the Productivity Commission[16] a non-binding Target will increase administrative, compliance and monitoring costs.

Therefore the phase-out of the scheme should occur when the scheme becomes non-binding or no longer a driver on investment decisions. This will depend on a number of factors however it is conceivable that the phase-out period from 2020 will be non-binding and an administrative burden.

In addition, any investments should be made aware of the proposed review of the effectiveness of the scheme in 2014 (considered further in Section 3.5 below).

3.5 Scheme review

APPEA supports a comprehensive review of the Scheme before 30 June 2014, as proposed in Section 162 of the Bill.

Section 162 of the Bill should, however, be amended to ensure that such a review includes a specific reference to whether the emissions trading scheme, which will have been in operation for three years by 2014, has removed the need for the Target's continuation. It is important that such a review allow for the possible termination of the Scheme before the proposed 2020 to 2030 timeframe outlined.

[16] Productivity Commission (2008), *What Role for Policies to Supplement an Emissions Trading Scheme?*, Productivity Commission Submission to the Garnaut Climate Change Review, May (available at www.pc.gov.au/__data/assets/pdf_file/0003/79716/garnaut.pdf).

A timely review would take place when the price of permits increases above the shortfall charge, as at this point

> … *the emissions trading scheme would come to dominate investment decisions and the economic effects of MRET would be subsumed within the emissions trading scheme*[17].

3.6 Multiplier for Renewable Energy Certificates

Where it addresses a clear market failure that is amendable to being addressed by Government intervention, encouraging the take up of renewable energy sources through efficiently designed complementary programs may be appropriate. As mentioned previously, however, we do not consider the Target as a complementary measure or an efficiently designed scheme.

Increasing incentives for micro electricity generation, should such a policy be necessary, through the sale Renewable Energy Certificates, as is proposed by the Bill's proposed amendments to Section 23B, is not the most cost effective measure and would appear to be a cumbersome addition to the scheme.

APPEA therefore recommends the amendments proposed to Section 23B, as contained in the Bill, not proceed.

3.7 The transition of State renewable energy target schemes

APPEA supports the Bill's proposal to allow State renewable energy target schemes to be transitioned into the national Target. Indeed, such provisions are essential to ensure that the inefficiencies inherent in the Target are not compounded by a proliferation of State-based targets.

[17] Professor R Garnaut (2008), *The Garnaut Climate Change Review: Final Report*, Cambridge University Press, Port Melbourne, p. 355 (available at www.garnautreview.org.au/pdf/Garnaut_Chapter14.pdf).

ATTACHMENT 1: CRA INTERNATIONAL REPORT *IMPLICATIONS OF A 20 PER CENT RENEWABLE ENERGY TARGET FOR ELECTRICITY GENERATION*