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Senate Select Committee on Fuel and Energy

By Email: [Kyriaki.Mechanicos@aph.gov.au](mailto:Kyriaki.Mechanicos@aph.gov.au)

### **Impacts of the CPRS on the energy supply industry**

The Energy Supply Association of Australia (esaa) has been invited to appear before the Senate Select Committee on Fuel and Energy to give evidence on the Association's submission to the Federal Government's Carbon Pollution Reduction Scheme (CPRS) Green Paper (attached). esaa, together with the National Generators' Forum, Energy Retailers' Association of Australia and Australian Pipeline Industry Association, made a comprehensive submission to the Green Paper (the joint industry submission), addressing the majority of proposed positions and providing considerable detail on the potential implications of the proposed CPRS on the energy supply industry.

In addition, the Committee has requested that esaa make a further submission on any material issues arising from the CPRS White Paper. esaa welcomes the opportunity to submit comment to the Senate Select Committee on Fuel and Energy on the potential impacts of the CPRS on the energy supply industry.

esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of over 40 electricity and downstream natural gas businesses. These businesses own and operate more than \$120 billion in assets, employ 49,000 people and contribute \$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 supply sector currently produces over 35% of Australia's greenhouse gas emissions and will be significantly impacted by the introduction of the CPRS. However, esaa considers that the implementation of a well designed national emissions trading scheme (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.

While esaa is broadly supportive of the Government's proposed CPRS design, this submission sets out some of the key challenges for the energy supply system in reducing emissions and increasing the proportion of renewable energy generation. The submission then considers the White Paper's response to the critical design features for an ETS outlined in the joint industry submission to the CPRS Green Paper including adequate structural adjustment assistance to coal-fired generators; sufficient tenure of Scheme caps and gateways; efficient permit auction design and the removal of barriers to full cost pass through to consumers. Finally, the submission raises some outstanding issues in relation to the taxation of permits.

### **Energy supply system – reducing emissions and increasing renewables**

The White Paper announced a national medium-term target range of between 5 and 15 per cent below 2000 level emissions by 2020, depending on the degree of international commitment to emission reductions. In addition, the Federal Government has committed to a 20 per cent renewable energy target in 2020.

Reducing emissions to 5 per cent below 2000 levels at 2020 could be seen as a modest target for Australia. However, some sectors of the community have suggested such a target is “soft” or “easy”.

A study undertaken for esaa by ACIL Tasman, *The impact of an ETS on the energy supply industry*, reported that Australia emitted 552mt CO<sub>2-e</sub> in 2000. Under a business-as-usual scenario (including existing greenhouse gas abatement policy measures) Australia is forecast to emit 664mt CO<sub>2-e</sub> in 2020. A 5% reduction on 2000 level emissions translates to a more than 20% reduction from business-as-usual. The modelling undertaken by the Federal Treasury has a more aggressive reference case and suggests emissions at 2020 would be 774.2 mt CO<sub>2-e</sub> in 2020. Under this scenario, a 5% reduction on 2000 level emissions would actually result in a nearly 30% reduction in emissions from business-as-usual.

This is an important consideration. If the economy is to steer towards the target range proposed, the early efforts to shift from the business-as-usual growth will need to be significant.

Currently over 80% of Australia's electricity is generated using black and brown coal, with a further 12% from natural gas while less than 7% comes from renewable sources. In contrast, the European Union has only 30% of electricity generated from coal, with a significant amount coming from zero emission sources such as nuclear (30%) and renewables (15%). Currently, there is no “off-the-shelf” technology to substantially reduce the greenhouse gas emissions from coal. Reducing Australia's emissions at 2020, while also implementing a 20% renewable energy target, will require fundamental change to the entire energy supply system in what is, in infrastructure terms, a very short time-frame.

The Treasury modelling suggests that a 5 per cent reduction on 2000 level emissions at 2020 will result in an emissions permit price of \$35 in 2020. It should be noted, however, that the Treasury only modelled scenarios where there was a comprehensive global agreement.

The Government has committed to a unilateral 5 per cent reduction on 2000 level emissions at 2020. This 5 per cent commitment is more akin to the Garnaut modelled scenario of a “Copenhagen compromise” than to the Treasury CPRS-5 scenario. Under Garnaut’s “Copenhagen compromise” the emissions permit price at 2020 is \$53. The White Paper does allow unlimited access to international permits but, in the absence of a broad and deep international emission permit market, the modelling would suggest that the permit price in Australia from the Government’s unconditional 5 per cent commitment would be somewhere between \$35 and \$53 in 2020.

The ability of Australian businesses to access a supply of international permits will be a key risk for the Scheme’s success.

The ACIL Tasman Study for esaa considered the impact on the energy supply industry of a \$42 and \$51 emission permit price at 2020 along with a 20 per cent renewable energy target.

#### *Generation infrastructure*

The ACIL Tasman Study found that an emission permit price of \$42 at 2020 and a 20 per cent renewable energy target resulted in several large power stations closing prior to their business as usual life. ACIL Tasman reported that 6,700MW of mostly coal-fired generation capacity in the National Electricity Market (NEM) would have to be closed, while the value of many other generation facilities would be substantially reduced. These closures would represent about 15% of current generating capacity on the eastern seaboard. Furthermore, the study found that 15,000 MW (including 1,200 MW in the South West Interconnected System (SWIS) of Western Australia) of gas-fired and renewable generation facilities would need to be constructed to replace these closed facilities. This amounts to a third of Australia’s existing installed capacity. The level of investment required in electricity generation over the period would therefore need to almost triple from \$13 billion to \$33 billion in real terms.

#### *Network infrastructure*

An altered generation mix and changed energy usage patterns would need to be accommodated by the transmission and distribution networks for both electricity and gas. These are the links between energy producers and final consumers and efficient and effective energy networks will be vital for the facilitation of a low emission energy supply system. This is recognised in the *Garnaut Review Discussion Paper*, which states that “a well integrated national energy network with the capacity to cope with potentially large shifts in energy flows will allow for structural change and the smoothing of shocks following the introduction of the emissions trading scheme”. Significant additional investment may be required in gas pipeline infrastructure along with considerable new investment in electricity transmission and distribution to meet the needs of a low emission energy supply system and ensure reliability of supply. The regulatory framework will need to accommodate these significant changes and enable the regulator to consider all costs incurred by network providers along with non-network options including embedded generation. However, at a time when additional investment in network infrastructure will be critical, the Australian Energy Regulator is proposing to substantially reduce the rate of return on network assets.

### *Managing the infrastructure transformation*

Even in perfect markets there are considerable lead times in the planning, permitting, construction and commissioning of large infrastructure projects. Should there be any imperfections in the supply of capital, labour and inputs, or in the regulation of the industry, then the security of Australia's electricity system could be jeopardised given its efficient system reserve capacity. Australia's system reserve capacity is designed to deliver an optimal energy cost in the current market environment – but is low compared to international comparators. In 2007-08 the NEM-wide system reserve was just 10% compared to the world benchmark of 15%. Based on median load forecasts, planning reserves will fall to 8% by 2010.<sup>1</sup> In the presence of a global financial crisis, sourcing sufficient capital to re-finance existing assets – many with shortened asset lives – and to invest in new capacity may prove particularly challenging.

The most effective way to manage these potential risks is not to delay or abandon the development of an ETS – this would only serve to increase investor uncertainty. A modest national emissions abatement target for 2020 is required as this will provide a smooth transition for the energy supply industry and allow the wider economy greater opportunity to adjust to one of the most fundamental structural adjustments ever applied by fiat.

However, even with a 5 per cent reduction in 2000 level emissions at 2020, a number of power stations will need to close while others will need to substantially reduce their production to meet this target. To ensure a smooth transition to a low emission economy and to secure future investment in a lower emission energy supply sector, those generators that suffer significant value reductions as a result of the introduction of the ETS should receive adequate structural adjustment assistance.

#### **Structural adjustment assistance to coal-fired generators**

esaa welcomes the Government's recognition in the White Paper that coal-fired generators will be strongly affected by the advent of the CPRS. As detailed below (and in greater detail in the attached Green Paper submission on pp 4-6 and 23-26), insufficient assistance 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. Insufficient assistance would 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 White Paper's proposed \$3.5 billion of assistance is insufficient and considerably lower than the consensus of modelling results (including two sets of Government modelling results) which suggest around \$10 billion of assistance is required over ten years. It should also be noted that for many coal-fired generators, the loss in asset value extends well beyond the first 10 years of the Scheme. In particular, for some coal-fired generators the most significant asset value loss will occur in the second decade of Scheme but these losses have been completely ignored by this assessment.

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<sup>1</sup> Simshauser, Nalder & Rolfe "Survival of "the pack" - on emission permit allocation policy, reliability of supply and incumbent power generators in Australia", June 2008.

### *Rationale for structural adjustment assistance to coal-fired generators*

Insufficient assistance 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. In fact, since the release of the CPRS White Paper, this has been triggered for at least one generator who will now be forced to trade through the spot market which will increase the likelihood of electricity price volatility. In addition, for many of those generators it could also 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 (particularly 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 scheme 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 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.

The provision of structural adjustment assistance can mitigate these effects. It is a demonstration by the 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 structural adjustment assistance, the Government effectively imposes a 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 objectives 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. Structural adjustment assistance 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 transitional assistance can help to minimise the impact such distress has on future investment decisions.

The 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 emissions trading scheme. Importantly, all of the national schemes that have been canvassed in recent years by state and federal governments have accepted the need for offsetting assistance to high emission plant adversely impacted by the introduction of a price on emissions.

#### *Insufficient structural adjustment assistance to coal-fired generators*

Under the CPRS, the electricity generation sector will be taxed around \$55 billion (real) on its emissions over the first decade of the Scheme.

The White Paper proposes to provide limited (\$3.5 billion) direct assistance to coal-fired electricity generators through the Electricity Sector Adjustment Scheme (ESAS) to ameliorate the risk of adversely affecting the investment environment in the sector. The quantum of assistance and allocation methodology are based on estimated extreme losses in asset value. According to the White Paper, it is the extreme losses, rather than the average loss across the sector that will impact investor risk perceptions.<sup>2</sup> However, the joint industry submission on the Green Paper argued that it is both the **scale and sum** of individual asset losses that matter, not just the scale of losses.

Subject to a number of eligibility criteria and submission to a windfall gain review, the White Paper commits to allocate approximately \$3.5 billion (130.7 million permits) to eligible generators over five years (despite estimated losses occurring over a much longer timeframe).

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<sup>2</sup> Page 13-13

To inform the decision on the required quantum of assistance, 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 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 \$3.5 billion would be sufficient assistance to coal-fired generators 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 \$3.5 billion 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. The limited assistance provided may not be sufficient to mitigate the risks identified.

## **Tenure and timing of announcement of Scheme caps and gateways**

### *Tenure of Scheme caps and gateways*

With adequate structural adjustment assistance for coal-fired generators, an emissions trading scheme 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 is intended to rectify this.

However, the White Paper's proposal to only commit to five years of firm Scheme caps is disappointing. esaa 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 White Paper proposes arrangements that would result in 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. esaa 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.

#### *Timing of announcement and tenure of initial Scheme caps and gateways*

To enable generators to write future hedge/bilateral contracts, the joint industry response to the Green Paper argued that the Scheme caps and gateway need to be announced as soon as possible and permits made available. Currently, there are very few hedge contracts being offered beyond June 2010 because the cap on greenhouse gas emissions in the CPRS is largely unknown. This uncertainty is also inhibiting the formation of bilateral contracts in the SWIS.

The White Paper proposed that in early 2010, prior to the CPRS commencement and after the passage of legislation through parliament, the Government:

- will announce Scheme caps for the first five years or to the end of any new international commitment period if the Government elects to do so; and
- intends to announce up to 10 years (contracting to five before extending to 10 once again) of Scheme gateways beyond the minimum five years of Scheme caps.

This series of announcements does little to address the current uncertainty in the electricity markets and is not a tenable approach for an industry that involves planning and construction of long-lived, capital intensive investments.

As a sentient transitional issue, esaa considers that Scheme caps should be announced as early as possible. Noting the White Paper's statement that the first two years of the Scheme cap will be aimed at meeting Australia's Kyoto commitment,<sup>3</sup> confirmation of these caps should be announced at least one year prior to the Scheme's commencement.

#### **Permit auction design**

esaa is supportive of the White Paper's long term objective of moving towards 100 per cent auctioning of permits after sufficient administrative allocations have 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

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<sup>3</sup> Page 10-2



support forward contracts. With an indicative national emissions target range of between 5 and 15% below 2000 level emissions at 2020, generators will need to hold permits well in excess of \$10 billion. This will significantly increase working capital requirements and exacerbate costs to meet prudential requirements.

The joint industry submission to the 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 commits to monthly auctions compared to the quarterly auctions proposed in the Green Paper.

In addition, the joint industry submission asserted 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 has also recognised this concern in the White Paper and has committed to considering deferred settlement arrangements in consultation with industry.

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 lack of availability of permits.

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 allocated for free. In fact, in the EU only 3-7% of permits will have been sold until 2012 with the rest freely allocated. While in a number of EU countries with a heavy reliance on coal-fired generation, free permits will remain until 2020. In contrast, the Australian market does not have such assurances and the White Paper's commitment to auction the first permits 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.

Reflecting the importance of an efficient auction design to the industry, esaa, along with the National Generators' Forum, Energy Retailers' Association of Australia and the Australian Financial Markets Association, are considering a number of auction design issues including options for a deferred settlement mechanism for future vintage permits and a transitional mechanism to enable the early auction of permits. This Auction Design Working Group will continue to work with the Government on an efficient and effective permit auction design.

### **Retail price regulation**

The regulation of retail electricity prices poses a significant threat to the efficient operation of the CPRS and the viability of retailers. For the Scheme to operate efficiently and provide least-cost emission reductions, consumers must be exposed to the cost implications of greenhouse gas emissions. Retail price regulation would prevent retailers from passing on higher wholesale energy costs in a timely manner.

Retailers could therefore experience significant losses and be unable to contract forward with the remaining generators, forcing their eventual exit. Systemic failure or financial distress among major retailers would increase volatility and risks in the energy market (which would cascade through to business consumers) and undermine reliability and security of supply.

In fact, the Australian Energy Market Commission in its 1<sup>st</sup> Interim Report for the Review of Energy Market Frameworks in Light of Climate Change Policies found that the current retail price regulation arrangements are not sufficiently flexible to be able to cope with the potentially large and rapid changes in retailer costs associated with the introduction of the CPRS.

The Government has acknowledged in the 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 response. However, it concludes that the optimal approach to progressing cost pass-through is to support the work of the Ministerial Council on Energy.

esaa has strong reservations as to the effectiveness of the proposed approach to facilitating appropriate and timely cost pass-through for retailers. The Australian Energy Market Commission's reviews of the effectiveness of competition in the various Australian jurisdictions is insufficient to ensure the removal of retail price regulation as there is no obligation on individual jurisdictions to remove retail price regulation even where the markets are demonstrated to be competitive. In fact, several State Energy Ministers have indicated that they will not remove retail price regulation even if their markets are shown to be competitive.

It has been suggested to the industry that the Ministerial Council on Energy could put forward an amendment to the Australian Energy Market Agreement for consideration by the Council of Australian Governments. This amendment would commit all jurisdictions to ensuring that CPRS costs can be passed on to customers. However, the industry considers that this approach would be insufficient. There are a number of jurisdictions where retail prices remain below the cost of supply and where there is political intervention into regulatory price setting. In addition, there have already been a number of commitments within the Australian Energy Market Agreement that have not been met and the industry has no reason to believe that this type of commitment would be effective.

esaa considers that retail price regulation should be removed. However, where Governments are unwilling to commit to this reform, at the very least there should be a consistent, national framework for the regulation of retail prices that enables cost-reflective pricing and the full pass-through of emission costs to consumers. The Australian Energy Market Commission should determine the appropriate methodology for ensuring cost-reflectivity and it should be applied by the Australian Energy Regulator.

## Taxation of permits

esaa considers that the tax system should not introduce distortions to the permit market and the Government's focus on simplicity, efficiency and equity in relation to tax in the White Paper is welcome. In particular, esaa endorses the proposal to create discrete provisions in the income tax law to provide uniform income tax treatment of permits for all taxpayers, increase certainty and reduce complexity.

In the joint industry submission to the Green Paper, and in other tax-related forums, esaa has provided feedback on a number of specific areas on permit tax treatment, which have subsequently been considered by the Government in the White Paper. However, esaa considers there are still outstanding issues with regard to taxation and the CPRS, in particular; approaches to treatment of administratively allocated permits; harmonising liability compliance with the tax year, including the challenges of equitable treatment of parties with differing year ends; and GST application.

The White Paper states that permits administratively allocated through ESAS will be assessable income for tax purposes at year end, unless surrendered during the course of the compliance year and prior to tax year end. Conversely, permits administratively allocated as assistance to emissions-intensive, trade-exposed (EITE) industries will be given nil value treatment for the tax year allocated.<sup>4</sup> Such approaches raise two key issues for esaa. Firstly, the esaa is concerned by the different tax treatment of ESAS assistance and EITE industry assistance. Secondly, the proposed tax treatment for ESAS assistance may have implications on the wholesale electricity market, and the abatement achieved by the energy supply sector. By categorising administratively allocated permits held at the end of the financial year as assessable income, the proposed tax treatment could inadvertently provide incentives for the most emissive coal-fired generators to continue operating and surrender the permits rather than closing and realising the income, distorting the efficiency and effectiveness of the CPRS and undermining the intentions of the ESAS.

The CPRS compliance year set out in the White Paper is the same as the Australian tax year, beginning 1 July and concluding 30 June the following year. The alignment of the CPRS compliance period with the existing Australian tax year and the National Greenhouse and Energy Reporting Scheme (NGERS) is welcomed by esaa. However, some challenges remain for industry members who have different reporting obligations.

In addition, the Association is concerned by the White Paper's approach to the tax treatment of permits surrendered to acquit a liability post 30 June but applicable to the previous compliance year. The White Paper states that the cost of acquiring a permit will be tax deductible when it is surrendered, regardless of whether the permit is surrendered to meet a liability in the previous tax and CPRS compliance year.<sup>5</sup> esaa considers that deductions for the cost of permits should be deductible in the tax year the CPRS obligation arises rather than the tax year permits are surrendered.

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<sup>4</sup> Page 14-16

<sup>5</sup> Page 14-9 – 14-12

Finally, the White Paper confirms the Government's position that the normal GST rules will apply to permit transactions. As the joint industry submission to the Green Paper stated (and other notable organisations such as the Tax Institute of Australia), esaa considers that permits should be exempt for GST purposes, to avoid a number of potential costs and distortions.

## **Conclusion**

esaa supports the introduction of the CPRS to provide an efficient price signal for the cost of greenhouse gas emissions and to ensure investor confidence in the energy supply industry. However, to deliver this investor confidence, adequate structural adjustment assistance is required for coal-fired generators to recognise their asset value loss from the introduction of the Scheme. In addition, the Government should commit to 10 years of firm Scheme caps followed by a 10-year rolling gateway to ensure there is sufficient information for investors to commit to long-lived capital assets and deliver a lower emission energy supply system. Ultimately, for the Scheme to be successful and to deliver a lower emission energy supply system, retail price regulation must be 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.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Clare Savage', with a long horizontal flourish extending to the right.

**Clare Savage**  
Acting Chief Executive Officer