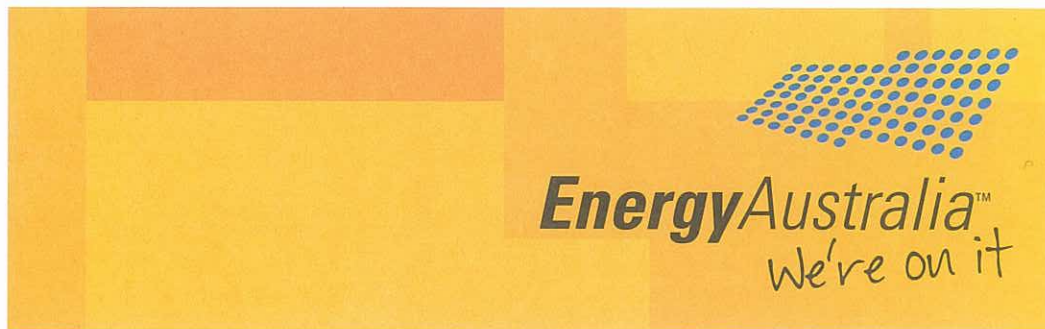


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28 April 2008

Greenhouse Gas Reduction Scheme Transition Review
Department of Water and Energy
GPO Box 3889
Sydney NSW 2001

By email: ggastransition@dwe.nsw.gov.au

Dear Sir or Madam,

Transitional Arrangements for the NSW Greenhouse Gas Reduction Scheme - Consultation Paper

EnergyAustralia welcomes the opportunity to comment on the Department's Consultation Paper - Transitional Arrangements for the NSW Greenhouse Gas Reduction Scheme (**GGAS**).

EnergyAustralia supports the implementation of a National Emissions Trading Scheme (**NETS**) and the NSW Government's legislated changes to ensure that GGAS ends when NETS commences. EnergyAustralia believes the transitional plan is an important arrangement for maintaining regulatory certainty and confidence in the carbon markets during the period leading up to the inception of the NETS. Moreover, the pro-active position taken by the NSW Government on this issue should provide the market with confidence for future investments in the NSW energy sector.

As a part of the Department's consultation process, EnergyAustralia would welcome the opportunity to provide further input or to become involved in any further process regarding the transition from GGAS to NETS.

Please find attached EnergyAustralia's specific comments on the questions contained in the Consultation Paper. Should we be able to provide any further comments please call Gregory Foy, Manager – Climate Change & Environmental Products or Philip Dixon-Flint, Regulatory Strategy Manager – Wholesale on 02 9269 4164 or 02 9269 2317.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Mike Bailey".

Mike Bailey
Executive General Manager Retail



EnergyAustralia's Submission on the
Transitional Arrangements for the
NSW Greenhouse Gas Reduction
Scheme

Consultation Paper
April 2008

Submission 28 April 2008



EnergyAustralia[®]
We're on it

4.1 Transitional Timeframe

Comment is sought on the view that transitional arrangements should only apply to the period from the commencement of the NETS to the end of 2012 in most instances. Where it can be demonstrated that investments were made after GGAS had been extended and before the Commonwealth Government had committed to a NETS, how should they be treated?

EnergyAustralia believes the proposal to have the transitional arrangements apply to the period from the commencement of the NETS to the end of 2012 will cover most investor circumstances, however we believe it may be necessary to extend the transitional arrangements beyond 2012. Post 2012 consideration in certain circumstances would accommodate those projects that were commenced or committed to in the period between the announcement of the extension of GGAS and the clear and unequivocal Federal commitment to implement a NETS following the 2007 Federal election.

This is proposed because:

Despite the extension of the GGAS scheme to 2021 and beyond (qualified on there being no operational NETS), EnergyAustralia believes the feasibility of a State based NETS as outlined by the Council for the Australian Federation on 9 February 2007, and independent of the Commonwealth, was always unclear. The State based scheme was dependent upon resolution of many issues including: firm details on design and coverage; the extent and impact of Commonwealth opposition; potential constitutional hurdles and the full participation of all states. For the market, there was generally a lack of firm detail on timeframes, coverage, targets and rules.

Therefore, after taking into consideration the potential impediments to the states' scheme, it would be reasonable to conclude that even after the State and Territory Governments made their announcement in February 2007, the likelihood of a State based scheme by 2010 seemed doubtful. This point is supported by the observation that if there was certainty of a State based scheme succeeding when announced in February 2007, there would have been a similar discussion to the one currently being held on transitional issues for NETS and GGAS following that announcement.

A similar scenario existed with the Commonwealth. In terms of Federal policy, on 3 June 2007 the then Federal Government outlined a policy for NETS to be introduced by 2012 but legislation was to be introduced following the Federal election due later that year. Similarly the then Federal opposition also announced their NETS policy would be legislated following the 2007 election.

With three potential NETS models proposed, the market was provided with little certainty. At the same time however, the market was faced with a legislated GGAS Scheme with very large compliance targets involving many millions of dollars of

investment. The market participants, including EnergyAustralia therefore could not afford to 'sit on the fence' and await the outcome. A firm timeframe for NETS only became clear in late 2007 due to the change in Federal Government that brought with it the ratification of Kyoto and some clear policy direction.

It is for the above reasons that EnergyAustralia would recommend against setting a firm transitional end date of 2012 and believes that an extended transitional timeframe should be considered for projects implemented between October 2006 and December 2007. Like other liable parties, EnergyAustralia did enter into a binding, long-term contractual obligation as described in 4.1 during this period - in the form of a Power Purchase Agreement (PPA) to meet its legislative GGAS obligations. This contract, with a face value of around \$80m, was entered into in 'good faith' and demonstrated a genuine commitment to meet mandatory GGAS obligations at the time and into the future.

These agreements represent a significant capital commitment for both the developer and the offtake purchaser, with revenue certainty a key component to secure funding. Therefore, such projects were undertaken over a long-term horizon and borne out of the prevailing regulatory obligations. Changes to the regulatory rules, after these projects have been committed, will naturally impact the value of these projects to either or both the developer and offtake purchaser.

EnergyAustralia's view is that the primary objective of the transitional plan should be to protect the commercial position or contract value of all parties to these arrangements. We believe that it is likely to be problematic to replicate this value outside of the GGAS scheme in which they were created.

It is therefore recommended that a case by case approach is required for these significant capital projects that are impacted by this regulatory change. A proposed working definition for a project of significant capital value as one having a total contract face value of at least \$5 million.

In addition, those investors claiming to have made an investment decision based on the extension of GGAS to 2021 should be required to clearly demonstrate the commercial arrangements of the project, prior to being granted access to any transitional arrangements.

Options for transition

EnergyAustralia believes one option available for the transition of PPAs where there is a clear loss of value to a party, might be to transfer such projects into a holding "transitional fund". The purpose of the fund would be to replace the offtake purchaser in the acquisition of NGACs that would have been created and delivered under GGAS at the agreed contractual prices. The fund would essentially quarantine these investments and thereby allow them to maintain the status quo of the transaction as when established under the GGAS legislation at that time.

The capital for the fund could be met out of Federal proceeds from the auctioning of permits. Alternative capital may be from any residual value from the NGACs in the form of NETS permits that are then sold into the market by the fund.

The fund would hold these contracts until their termination or 2021 whichever ever occurred first. Administratively, the fund could be established by the NSW Government and managed by an independent regulator such as IPART.

Although the "transitional fund" model may result in an extended transitional or run-off period, the proposed model would ensure that actual costs or benefits, as expected by the parties under GGAS, are accurately determined.

EnergyAustralia believes that this type of model might be considered as an alternative to an up-front, one-off allocation of permits as outlined in the Consultation Paper. That is; "*(the regulator) required to estimate the plant's operating profits for a 20 year period in the absence of the NETS (but with GGAS until the end of 2012), and then the change in operating profits for that same period with the NETs (and no GGAS)*". This model appears problematic for two reasons. Firstly, there is sound argument, as above, for the GGAS estimate to be made out to 2021. Secondly, the estimation of a plants operating profits for a 20 year period, seems to be very arbitrary and therefore open to dispute. EnergyAustralia believes that it would be extremely difficult to arrive at a satisfactory compensation outcome that results from the early termination of GGAS.

EnergyAustralia believes the holding transitional fund proposal, as outlined above may provide more opportunity to meet the transitional objectives of effectiveness, fairness and regulatory certainty over expediency. A key advantage of a transitional fund over the model proposed in the Consultation Paper is that it is not dependent on numerous modelling assumptions.

4.2.1 Permits for Fossil-fuel generators.

Do you support either of these options? If these options are not supported, are there other options that stakeholders wish to propose?

EnergyAustralia believes it can be reasonably expected that electricity generators will pass through the impact of NETS on their business by simply increasing wholesale prices of electricity, regardless of whether permits are auctioned or allocated. The market will then determine whether the generators set a uniform pass through increase, or exhibit differential behaviour in bidding and hedging contracts based upon variable emissions per plant.

A possible scenario where some adjustments to the position of generators may be necessary is for those generators that will lose NGAC revenue or entitlements without the benefit of a corresponding NETS price advantage from the wholesale electricity market. Transitional arrangements should be considered where it can be clearly demonstrated that generation projects or upgrades resulting in lower emissions were undertaken based on the expectation of NGAC revenues or entitlements beyond 2010 and under NETS there is a proven proportional loss to that party.

Depending on the final NETS model, such a mechanism might be funded out of the revenue from the permit auctions, the EnergyAustralia proposed transitional fund or through some free permit or offset allocation.

4.2.2 Waste Coal Mine methane generators and landfill gas (or other waste methane)

Are these transition options supported? If not, are there other options that stakeholders wish to propose?

Under GGAS rules, generation projects involving the use of waste coal mine gas or land fill gas were able to register multiple NGACs per unit of generation. In general, these projects were financially viable due to long-term PPAs incorporating the delivery of large volumes of NGACs, and entered into with an electricity retailer at a higher purchase rate than might have otherwise been paid for the electricity to be generated.

With the coverage of the sectors under NETS currently unclear, it is uncertain as to whether any emissions benefit would continue to exist post GGAS to support the higher purchase rate paid by the retailer under these PPAs.

As indicated in the previous section, EnergyAustralia supports the concept of transitional arrangements supporting GGAS accredited generators with appropriate compensation in the years beyond 2010, and where applicable out to 2021. In the case of waste mine and landfill gas generation, similar arrangements should be considered to compensate the party (generator or purchaser) that may have been commercially disadvantaged due to the removal of the NGAC benefit through the transitional arrangements.

The compensation mechanism in the proposal by EnergyAustralia for a holding "transitional fund" might be well suited to addressing these projects. The arrangements should be used to restore the commercial position of either the retailer under the PPA or the generator, as existed under GGAS, and could be assessed on a case by case basis.

Where mines and land fill gas sites that emit fugitive wastes are deemed to be covered under a NETS – the facility that has entered into binding arrangements to sell the waste methane to generate electricity should be excluded from requiring permits. They should be rewarded for early action - having prevented methane being emitted into the atmosphere, whilst relying on the apparent investment certainty of the prevailing regulatory regime.

4.2.3 Category A Generators

Comment is sought on this transitional approach. Are there any other options that stakeholders wish to propose?

EnergyAustralia agrees with the approach outlined. Potential arrangements to compensate Category A Generators should be based upon the net financial impact of the NETS and removal of the NGAC benefit from 2010 to 2012.

4.2.6 DSA abatement certificates

Comment is sought through this process on options to effectively deal with DSA projects in the transition to a NETS.

It is EnergyAustralia's understanding that the current design model for NETS has specifically considered the inclusion of an energy DSA element within the scheme but found, on the basis of economic efficiency, it would add an additional cost burden to society. This position is supported in the Garnaut Climate Change Review's 'Emissions Trading Scheme Discussion Paper', in that market mechanisms such as the proposed energy efficiency trading scheme can negatively impact the efficiency of the NETS and the goal of lowest cost greenhouse gas emission reductions.

Due to this, and the double counting issues outlined in the Consultation Paper, EnergyAustralia believes that the DSA component of GGAS should therefore conclude with the end of GGAS. Transitional arrangements from GGAS could therefore examine, on a case by case basis, continued support of existing DSA projects via the NSW Climate Change Fund in lieu of the NGAC revenue that would have supported the initiative under GGAS.

4.3 Unused Abatement Certificates

Are either of these transition options supported? If not, are there other options that stakeholders wish to propose.

As the largest liable party under GGAS, EnergyAustralia supports some type of arrangement where unused certificates may be traded for NETS offsets at the conclusion of the GGAS Scheme. Clearly in any exchange arrangement the 'value' of the NETS permits versus the unused NGACs would need to be carefully considered to avoid the equity and market issues outlined in the Consultation Paper.

In the absence of an exchange mechanism, our earlier proposal for a holding transitional fund for these certificates may also have application for unused certificates.

Yet another alternative option for unused certificates could be an allowance to recover the actual costs of the unused certificates from customers. Once the costs are recovered no further charges are passed through to customers.

As indicated in the previous section, a post GGAS, 'DSA only' scheme is not supported. If however, it is decided that the DSA portion of GGAS is to be maintained in NSW, consideration should then be given to a direct 1:1 swap of unused NGACs for the DSA certificates irrespective of source.

4.4 New Accreditations

Are either of these transition options supported? If not, are there other options that stakeholders wish to propose?

As indicated in a previous section, the certainty of a NETS came after the outcome of the 2007 Federal election was known. Although the election was held and determined in November 2007, for added simplicity, EnergyAustralia would support a cut-off date for transitional assistance is made for applications lodged on or before 31 December 2007.

4.5 Ending liability under GGAS

Comment is sought on any issues arising from the ending of GGAS liabilities.

EnergyAustralia would request that the end date of the scheme liability be made clear at the soonest possible time. In the interim, and in the absence of precise timing of NETS introduction, consideration should be given to providing the market with policy advice relating GGAS termination based upon the scenario for a 1 July 2010 and a 1 January 2011 commencement date for NETS.