



29 April 2008

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

cc by email: ggastransition@dwe.nsw.gov.au

Transitional arrangements for the NSW Greenhouse Gas Reduction Scheme – Consultation Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to provide comment and feedback to the Department of Water and Energy, regarding transitional arrangements for the NSW Greenhouse Gas Reduction Scheme (GGAS).

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 some \$110 billion in assets, employ over 40,000 people and contribute \$14.5 billion dollars directly to the nation's Gross Domestic Product. The esaa is fuel and technology neutral, and represents businesses that have investments across a wide range of fossil fuel and renewable generation technologies.

esaa supports the development of a sustainable, low carbon emission stationary energy supply system at least cost. This objective is most effectively achieved by implementing an efficient economy-wide national emissions trading scheme (ETS) as the primary emissions reduction signal, supplemented only where justified with complementary measures that do not compromise the objective of least cost abatement (see Attachment A, the esaa ETS Design Principles).

esaa notes that the Council of Australian Governments (COAG) agreed in December 2007 to establish a single national ETS and an "implementation plan for developing a coherent and streamlined set of climate change measures across jurisdictions to complement Commonwealth implementation of an ETS." COAG in March 2008 reiterated the commitment to cooperative action and agreed to finalise a comprehensive framework for addressing climate change at its October 2008 meeting.

The New South Wales Government has long supported the introduction of a national ETS, demonstrated by its participation in the National Emissions Trading Taskforce (NETT) in 2006 and the COAG agreement of December 2007. Additionally, together with the other State and Territory Governments of Australia, the NSW Government

commissioned the Garnaut Climate Change Review in April 2007 to undertake a comprehensive review of the impact of climate change, and to recommend short and medium term policies for mitigation and adaptation to produce the best possible outcome for Australia. The Commonwealth Government has subsequently joined the states in participating in the review, which is scheduled to issue a draft report in June 2008 and a final report in September 2008.

The NSW Government launched GGAS in 2003 as one of the world's first mandatory emissions trading schemes. GGAS consequently stimulated significant investment and capacity building in a fledgling industry both in NSW and across the National Electricity Market (NEM). The discontinuation of GGAS was foreshadowed in 2006 when the Electricity Supply Act 1995 was amended to prescribe the circumstances under which GGAS was terminated. esaa welcomes the emergence of a national policy consensus around the need for a single national ETS (NETS), and the subsequent recognition by the NSW Government of the necessity to cease GGAS.

As the first greenhouse gas abatement market-based instrument to require transitioning to a new scheme, there is considerable precedent value in the GGAS-NETS transition. Investor certainty will be compromised, and future investment in other legislatively-created markets may attract a higher risk premium, if the transitional arrangements do not adequately address the losses that some investments will suffer due to the GGAS market ending early to accommodate the introduction of the NETS.

The diversity of participants under GGAS is reflected in the Consultation Paper and the variation in transition propositions for each category of participant. Cessation of GGAS not only ends the liability imposed on Benchmark Participants, but also discontinues the opportunity to create NGACs. Consequently, market participants on both the demand and supply side of the GGAS market may suffer loss from its discontinuation. However, not all GGAS participants will directly transition into the NETS as a covered sector inclusion, and this will complicate the identification of adversely impacted investments and appropriate transitional assistance.

esaa supports full compensation for investments and contracts made under GGAS that suffer a net loss due to the early cessation of the scheme and transition to the NETS. In the case of covered sectors, this compensation would preferably be integrated with transitional assistance provided to affected entities upon the commencement of the NETS. Alternatively, if the NETS does not undertake to provide compensation then it should be provided by the NSW Government.

Compensating GGAS participants who are outside of the NETS covered sectors will require caution, to ensure distortions are not introduced that compromise the new market. esaa does not support an exchange of instruments that will either increase confusion in the new market, or create incentives to exploit any transition or compensation provisions. Generally, compensating GGAS participants who are outside of the NETS should be undertaken directly by the NSW Government, as they are unlikely to be eligible for any transitional treatment that may be undertaken for the NETS covered sectors.

Finally, it is noted that there is a sub-working group that is focused on the issues of transitioning participation under the Demand Side Abatement (DSA) Rule potentially to a new program. Whilst Premier lemma's support for energy efficiency measures to be implemented nationally¹ is positive, esaa recommends NSW defer any new policy measures such as an energy efficiency trading scheme until the Garnaut Review has delivered its recommendations and COAG has finalised its comprehensive climate change framework. This approach will provide a more integrated, nationally consistent and least cost strategy for implementing climate change policy measures. Existing investments made under the DSA Rule should be directly compensated on the same basis as all other investments for any net losses suffered by the early end of the GGAS market and transition to national arrangements.

To summarise, esaa believes that investments and contracts made in good faith under GGAS should be fully compensated at the commencement of a national ETS. This compensation should be facilitated either by arrangements that may be developed for the national ETS, or directly by the NSW Government in the absence of compensation measures applicable to activities authorised under the GGAS. This approach will minimise the risk profile of future investments in policy-induced ETS markets. Any new programs additional to the national ETS, such as energy efficiency schemes, would be most effectively managed at least cost if decisions were informed by the pending Garnaut Review report and COAG's delivery of a single national climate change framework for policy makers.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brad Page', with a stylized flourish at the end.

Brad Page
Chief Executive Officer

¹ Premier of New South Wales News Release, 10 December 2007.



esaa Emissions Trading Scheme Design Principles

The esaa Emissions Trading Scheme Design Principles are guided by the overarching principles of:

- **Effectiveness and efficiency (particularly dynamic efficiency)** - the scheme should promote efficient investment in, and use of, energy services to achieve the desired reliability, security of supply and abatement at least cost over the medium to long term.
- **Equity** - affected parties should not be treated unfairly relative to others.

Targets and timing

A single long term, economy-wide, emissions abatement target should be established for 2050. An abatement trajectory should be fixed by setting firm short-term targets of 10 years duration and medium-term indicative targets for an additional 10 years.

The short-term targets should be set as soon as practical at a level that provides for a manageable economic transition and is informed by the availability of emissions reductions across covered sectors.

Coverage

The ETS should cover all significant greenhouse gas emitting sectors, sources and sinks, including the stationary energy, transport, industry and agriculture sectors.

Any excluded sectors should face emissions constraints at least equal to the covered sectors through alternative policies.

Permit allocation, forward markets and transitional arrangements

Allocation of permits should be undertaken by auction at a national level based on a single national target, after the provision of transitional assistance to disproportionately impacted industries. Auctions should be held at regular intervals to minimise impacts on cash flow.

A liquid forward market should be created through the allocation of future dated permits or equivalent means.

Transitional assistance should be provided to existing greenhouse gas emitting entities to compensate for any disproportionate loss of economic value suffered due to the introduction of the ETS. Economically efficient compensation should be calculated on an asset by asset basis, by an independent regulator using a transparent methodology, on commencement of the ETS.

Investments and/or contracts made in good faith under existing greenhouse abatement schemes to be transitioned into the ETS, or ended early, should be fully compensated.

Any additional compensation or subsidies that may be provided to trade exposed energy intensive sectors should minimise distortions to the ETS market and impacts on other industries.

Compliance penalty

The penalty should be set at a level that is above the expected marginal cost of abatement, but is not punitive. The penalty should be informed by, and no lower than, the implied cost of carbon of any pre-existing state based schemes to be transitioned into the national ETS.

An ETS should not contain a 'make good' provision in addition to financial penalties.

Offsets and linkage

To the extent that new low-cost abatement or sequestration opportunities arise (either domestically or internationally) these should be incorporated into the ETS.

Provided Australia is not disadvantaged by its participation, an Australian ETS should be linked (in some form) to complementary international schemes to lower the cost of abatement.

Cost transparency

Energy markets should be allowed to efficiently include the cost of carbon throughout the supply chain, free from regulatory inhibitors such as price controls. To the extent that assistance is required to ameliorate the impact of the ETS on affected consumer groups, this should be funded and provided directly by Government.

Institutional arrangements

The ETS should be administered by a regulator that is independent of the policy and rule making authorities. The ETS should be supported by efficient measurement and reporting arrangements, and an efficient exchange to facilitate low-cost, transparent transactions.

Research and development

A significant proportion of revenues generated under the ETS should be invested in emissions abatement activities including research, development and deployment of low emissions energy technologies.

Tax

To maximise efficiency in emissions abatement, the tax system should not introduce distortions between purchasing permits and other options.

Taxation implications should be considered in the calculation and provision of transitional assistance.