

Greenhouse Gas Reduction Scheme Transition Review  
Department of Water and Energy  
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## **Submission to Transitional arrangements for the NSW Greenhouse Gas Reduction Scheme**

Snowy Hydro appreciates the opportunity to comment on the NSW Department of Water and Energy's ("DWE's") Consultation Paper "*Transitional arrangements for the NSW Greenhouse Gas Abatement Scheme*".

Snowy Hydro believes that the NSW Greenhouse Gas Abatement Scheme "**GGAS**" has been very successful in providing incentives for abatement certificate providers to reduce the intensity of their greenhouse gas emissions. It is therefore important that there is a smooth transition between GGAS and the incoming National Emissions Trading Scheme ("NETS") which protects the legitimate business interests of those abatement certificate providers while ensuring that the environmental integrity of the Federal Government's environmental policy is maintained.

### **Proposed Objectives for Transition Plan**

Snowy Hydro agrees with DWE's proposed objectives for a transition plan from GGAS to NETS as set out on page 3 of the Consultation Paper, which are:

1. **Effectiveness** in reducing greenhouse gas emissions by maintaining:
  - a. Maximum consistency with the objectives and key design features of both GGAS and the NETS;
  - b. Incentives to comply with GGAS obligations prior to NETS commencement; and
  - c. Incentives to pursue greenhouse reduction projects to the same extent during the transition phase and in the early years of the NETS;
2. **Efficiency**, by ensuring that the transitional arrangements do not detract from the overall economic efficiency of GGAS and the NETS, in particular to effect abatement at minimum cost;
3. **Fairness** by ensuring that investments made viable as a result of GGAS are not rendered uneconomic by the termination of GGAS and its replacement with a NETS; and
4. **Regulatory certainty and confidence in carbon markets** by minimising avoidable impacts of the transitional arrangements and the termination of GGAS on both the NGAC and NETS permit markets.

Snowy Hydro submits that these objectives should be applied to any transition plan to be negotiated by the NSW Government with the Federal Government.

In particular, Snowy Hydro submits that the transition plan should provide incentives for GGAS participants to continue to reduce greenhouse gas emissions up to the commencement of the NETS if the cost of mitigation is less than the NGAC permit price. Creating incentives for an efficient level of participation in the GGAS will maintain the economic efficiency and the effectiveness of GGAS, and will not hinder the integrity of the NETS.

It is also essential that the objectives of fairness and regulatory certainty are upheld in the transition to the NETS.

In relation to the fairness objective, abatement certificate providers have invested in the GGAS program on the basis of receiving an adequate return for their investment. Therefore, the transition plan should allow for those providers to receive a return for this investment despite the early cessation of GGAS.

With regard to the regulatory certainty objective, uncertainty as to what will happen to unused NGACs, and to what transition arrangements will be introduced from 2010 to 2012, has already reduced confidence in the NGAC permit market and increased the risk for participants in that scheme. As a result NGAC prices have decreased. It is therefore critically important that all areas of regulatory uncertainty are addressed as soon as possible so that GGAS participants can re-establish confidence in GGAS and continue to pursue greenhouse gas reduction projects leading up to and into the transition phase.

### **Unused Abatement Certificates**

The remainder of Snowy Hydro's submission focuses on Section 4.3 of the Consultation Paper: Unused Abatement Certificates.

Snowy Hydro believes that appropriate treatment of unused NGACS is important to maintain investor confidence in the remaining years of GGAS.

The Consultation Paper proposes that one possible transition option is to swap unused NGACs for NETS permits on a tonne for tonne basis at the start of the NETS. These permits would come from the existing cap and hence would not affect the integrity of the NETS.

Alternatively, unused NGACs could be swapped for offset credits on a tonne-for-tonne basis at the start of the NETS with the credits being taken into account in the setting of the annual caps. Once again this would not affect the integrity of the NETS.

Snowy Hydro believes either approach would satisfactorily maintain investor confidence in the GGAS for its remaining years because:

- early action by GGAS abatement certificate providers to abate greenhouse gases should be financially recognised (and in that way the effectiveness and fairness objectives are satisfied);
- a tonne of greenhouse gas abatement achieved by a GGAS abatement certificate provider and represented as an NGAC is equal to a tonne of CO<sub>2</sub>e not being released in the atmosphere; and
- providing a clear decision on this issue as soon as possible would provide regulatory certainty to GGAS market participants and allow the market price of NGACs to emerge unaffected by uncertainty as to the treatment of unused NGACs (thereby satisfying the efficiency objective and the objective of regulatory certainty and confidence in carbon markets).

Snowy Hydro believes neither of the two transitional arrangement options for unused NGACs create incentives for GGAS participants to hold NGACs and restrict their supply to liable parties in the lead-up to the NETS, or for liable parties under GGAS to hold NGACs and fail to comply with GGAS, choosing instead to pay the GGAS penalty. This is not only due to the importance companies place on reputational and compliance issues but is also because the final design elements of the NETS (such as the target trajectory, banking and borrowing etc) are inherently uncertain. Therefore withholding NGACs for an assumed higher NETS permit price would be a risky proposition for an abatement certificate provider. Hence Snowy Hydro

submits that abatement certificate providers would rather realise the NGAC revenue on offer than risk an uncertain NETS permit price.

Snowy Hydro recognises that either option could create an incentive for GGAS abatement certificate providers to create more NGACs than would otherwise have been supplied up to the start of the NETS in order to take advantage of the transition option. One way to mitigate this issue is for the Federal Government to legislate for the automatic exchange of NETS permits (or offset credits) for unused NGAC permits of 2007 vintage or earlier. This would be consistent with the Transition Plan Objectives because these NGACs were created from generation that occurred prior to the Federal Government's commitment to introduce a NETS, and at a time when GGAS Participants legitimately expected that GGAS would continue until at least 2012. In addition, for the period that GGAS participants ought to have known that a NETS was to be implemented (2008, 2009, and 2010) an over-production limit could be placed on generation based on the 110% of the historical generation level of year 2007. Generation in the 2008 to 2010 calendar years beyond this 110% level would be ineligible to create NGACs. This would reduce any incentive to create more NGACs than would otherwise have been supplied up to the start of the NETS in order to take advantage of transitional arrangements.

If the Federal Government and the NSW Government did not agree that unused NGACs should be swapped for NETS permits or offset credits on a tonne for tonne basis, Snowy Hydro's less preferred option would be for unused NGACs to be exchanged for NETS permits at the start of the NETS based on the estimated values of the two types of certificates.

The problem with this option is that the price for NGACs has been depressed due to uncertainty surrounding the future of GGAS, and it is expected that the initial NETS permit price may be volatile due to the thin liquidity of the market and the fact that the market will need to bed down in the early days of the NETS. Hence, in order to satisfy the efficiency and fairness objectives, an exchange of NGACs for NETS permits (or offset credits) would need to take these factors into account.

Snowy Hydro suggests a fair and reasonable method of value conversion would be to use the forward 2010 price of NGACs (in the period before the NETS was a policy position) as the value of NGAC permits in 2010 ie. an average of NGAC 2010 forward prices published by brokers before the current Commonwealth Government's decision on 24 November 2007 to implement the NETS by the end of 2010.

If you would like further clarification of any of the points raised in Snowy Hydro's submissions, please call me on 02 9278 1862.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K Ly', with a stylized flourish underneath.

Kevin Ly  
Manager, Market & Regulatory Strategy