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Greenhouse Gas Reduction Scheme Transition Review  
Department of Water and Energy  
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### **“Transitional Arrangements for the NSW Greenhouse Gas Reduction Scheme”**

TRUenergy appreciates the opportunity to comment on the Consultation Paper:  
Transitional Arrangements for the NSW Greenhouse Gas Reduction Scheme (the Paper).

First, TRUenergy would like to acknowledge the NSW Government for delivering a comprehensive and considered consultation document. The Paper provides a sound basis for further discussion and analysis of the relevant issues.

TRUenergy has elected to comment on the following sections of the Paper.

<p>3. <i>Comments on objectives for a transition plan</i></p>
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The objectives of the transition plan have been well articulated.

In the TRUenergy's view, the central purpose of the transition plan is 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 ...”.

The specification of this objective can and ought to be improved by making the following amendment:

“... by ensuring that investments made viable as a result of GGAS are not rendered uneconomic [or less economic] by the termination of GGAS and its replacement with a NETS ...”.

The continued success of GGAS and the initial success of ETS will be influenced by the extent to which the transition plan can deliver on this objective. Policy makers cannot afford to treat sovereign risk and consequent timing and cost of future investments as second order issues when designing and implementing climate change policy.

*4.1 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?*

Transitional arrangements ought to extend until 2020 for all investments (the legislated timeframe of GGAS, potentially, in the absence of NETS). This is not to say that GGAS ought to necessarily operate until 2020 but rather that any calculation of loss to GGAS investors ought to assume GGAS until 2020 in its base case. Nor does this necessarily imply that all investments will be loss making for the entire period until 2020.

The NSW Government's commitment to abatement is clear, both historically and prospectively. As stated in the NETTS Discussion paper of August 2006, the NSW Government's intention in providing an extension to GGAS was to provide "certainty to the market and industry that ... projects would continue to have value beyond the end of the current scheme in 2012, if agreement on a NETS is delayed" and that the "NSW Government would consider measures for a smooth transition to a national scheme or continuation of GGAS, as appropriate" (p. 187).

Implicit here is the Government's desire to bridge the potential for a policy gap between expiry of GGAS and commencement of a NETS. In TRUenergy's view, bridging the gap amounts to more than simply joining the two schemes in time, without consideration of the value differential between the two schemes. From an investor's perspective the value and timing of a NETS relative to GGAS are both critical variables for regulatory certainty. Any calculation of NGAC revenues ought to extend to the legislated potential timeframe of GGAS to ensure that policy gap is in fact bridged in both value and timing terms.

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

In TRUenergy's view the inclusion of NGAC revenue in the allocation of free permits to otherwise disproportionately disadvantaged generators would be a relatively neat and effective mechanism for achieving the objectives of the transition plan (and importantly, one that does not violate the environmental integrity of either GGAS or NETS). However, contrary to the option expressed in the Paper, this would apply only if the calculation of the base case (i.e. without NETS) assumed GGAS existed until 2020 (as suggest above).

It is important to note that moving from 2012 to 2020 in the base case for calculating NGAC revenue:

- does not require GGAS to actually operate beyond the commencement of the NETS in 2010;
- effectively ensures that all investments under GGAS (before an appropriate cut-off date) are fully protected by transition arrangements;
- will only be material if expected permit prices under NETS (from 2012 to 2020) are lower than expected NGAC prices under GGAS (at any time between 2012 and 2020).

The 3<sup>rd</sup> dot point above is worth bearing in mind given the available estimates of permits prices under NETS. Modelling conducted for the NETTS Discussion paper of August 2006 estimates permits in 2012 to be between \$8 and 15/tCO<sub>2</sub>, rising rapidly to between \$10 and 20/tCO<sub>2</sub> by 2015. Moreover, these estimates for permit prices are substantially lower than other estimates from other modelling exercises, such as those conducted for the National Generators Forum.

As acknowledged in the Paper, the current Australian Government may not elect to allocate free permits to generators (despite preferences for this approach under the previous Australian Government and jurisdictions via the NETT process). Under this second best-policy scenario, TRUenergy supports allocation of an adequate portion of the auction revenue to achieve the objectives of the transition plan.

*4.3 Are either of these options supported? If not, are there others options that stakeholders wish to propose?*

TRUenergy supports the concept of converting unused NGACs into national emission trading scheme permits when the GGAS is terminated.

TRUenergy's preferred method would be to base the conversion rate on a one-for-one recognition of NGACs for national permits at the end of GGAS. As noted in the consultation paper, if the conversion of permits reduces the number of permits allocated under the national trading scheme by an equivalent amount, there is no diminution of environmental outcomes under this approach.

If a straight one-for-one conversion is not acceptable to the Commonwealth Government, an alternative would be to apply the relevant GGAS penalty fee at the time of GGAS terminates (adjusted by the company tax rate to reflect the fact that penalties are not a taxable expense). The conversion rate may require some small discount to the penalty rate to encourage benchmark participants to acquit permits. Under this approach, by way of example, if the GGAS penalty fee was half the expected or actual permit price at the time the national scheme commenced, after which participants would receive one-half of a national permit for every surplus NGAC held. Similarly, if the permit price was equal to the GGAS penalty fee, this method would be equivalent to a straight one-for-one conversion.

The early announcement of how the Commonwealth Government intends to deal with surplus NGACs at the end of the scheme has the potential to alleviate a major problem emerging in the electricity market. Ongoing uncertainty about the timing of a national trading scheme, the level of emission caps and the likely level of permit prices is reducing liquidity in the various electricity derivative contract markets. Generators, retailers and traders are finding it increasingly difficult to agree on a carbon price for contracts in 2010 and beyond. Reduced liquidity can result in higher risk premiums by investors unable to hedge the output of new projects and subsequently higher prices for customers and the use of.

A decision to recognise NGACs on the basis of a tonne for tonne conversion would encourage greater contracting in the forward market if it helped with permit price discovery. This could be a major flow-on benefit for all participants from joint NSW and

Commonwealth Government agreement on a preferred approach to the key transitional issues.

4.4 *Are either of these options supported? If not, are there others options that stakeholders wish to propose?*

TRUenergy supports the second option:

“set a cut-off date for transitional assistance, such as those that lodged applications for accreditation on or before 1 September 2008, after which no transitional assistance would apply”.

Using the date of lodgement for accreditation rather than the date of achievement of accreditation as the basis for a cut-off date fulfils on the intention of the transition plan. This also avoids the perverse incentive for new parties to become NGAC creators between the release of NETS design parameters/supporting legislation; and actual implementation of NETS.

TRUenergy looks forward to further participation on the Transition Review Working Group and would very happy to expand on the comments made above.

Please feel free to Leila Ngadi (Carbon Trading Manager) or Steve Wright (Carbon Policy Manager) in the first instance on 03 8628 1281 / 03 8628 1183 regarding any aspect of this submission.

Yours Sincerely,

*[signed]*

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