



GRIFFIN ENERGY

15th Floor
28 The Esplanade
Perth, Western Australia, 6000

Telephone: (08) 9261 2800
Facsimile: (08) 9486 7330

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Climate Change Group
Department of Prime Minister & Cabinet
PO Box 6500
CANBERRA, ACT, 2600

Email: emissionstrading@pmc.gov.au

Dear Sir / Madam,

RE: Griffin Energy Submission – Early Abatement Incentives Discussion Paper

Griffin Energy (Griffin) welcomes the opportunity to make a submission to the ‘Early Abatement Incentives Discussion Paper’. Generally, Griffin supports the introduction of an Australian Emissions Trading Scheme (ETS) and considers essential a robust engagement with the business community to formulate efficient parameters of operation.

Griffin provides comment on the following issues raised in the discussion paper:

2.2 Assets eligible for compensation

With a change in government occurring during the period from when the discussion paper was released to when submissions are due, Griffin questions the firmness of the 3 June 2007 date being used as a cut-off date for asset eligibility. While we acknowledge the requirement of a cut-off date, in the interest of investor certainty, we believe this should be clarified as a matter of urgency.

The concept of an asset being ‘in existence’ at a certain point in time will have different meanings for different assets and industries. In the electricity generation sector alone, the guidelines for a determining an existing asset in the National Electricity Market (NEM) vary to those which determines whether an asset is ‘under construction’ in the Western Australian Wholesale Electricity Market (WEM). Griffin agrees with the principle that a (new) existing asset is one where the asset has been ‘irreversibly committed’. To this end, Griffin concurs that the NEM criteria (set out in Appendix A of the discussion paper), offers appropriate *guidance* to a Regulator in

making a decision on an assets existence on the cut-off date. However these criteria should not represent a definitive list and are not without their limitations.

For example: One of the NEM criteria stipulates that:

Financing arrangements for the proposal, including debt plan, have been finalised and contracts executed.

This is a restrictive criterion as it is possible for developments to be irreversibly committed without having executed debt financing contracts, such as projects being financed through construction on balance sheet. The ‘under construction’ criteria in the WEM provide a less rigid definition relating to finance (yet just as robust when determining financial commitment to the project):

Formal commitment, including financial approval, on behalf of the company in respect of the project, for example Board approval.

Griffin’s main concern with the NEM criteria being used as a definitive check-list is that these criteria have been developed for purposes different from that intended under the asset eligibility test for permit allocation. The NEM criteria implemented by NEMMCO¹ (and those used in the WEM implemented by the IMO²) are biased toward risk aversion, in that the consequence of a ‘committed asset’ not progressing is a potential deficiency in capacity to meet market demand. Failure of the criteria imposes a direct consequence on the entity setting the criteria. The principle purpose of the asset eligibility test for permit allocation is to determine if the decision to irreversibly commit to an asset had been made, taking into account prevailing market conditions, prior to the cut-off date. Failure of the criteria imposes a direct consequence on the asset holder.

Bearing in mind that the evaluation of assets as being in existence as at the cut-off date is a one-off process; that the number of assets that will potentially face such a determination will be relatively small; and that the financial implications to committed investments may be large, Griffin suggests that the Regulator use the NEM criteria for guidance in making its determination, along with other mitigating factors applicable to each individual asset and the industry and jurisdiction it is in.

3.3 Administrative arrangements

Griffin agrees that in the timelines applicable for developing appropriate mechanisms for approving and administering offsets, that it is sensible to make use of existing platforms in the interim. The Greenhouse Friendly programme seems a reasonable choice for the initial administration of early action abatement schemes.

Greenhouse Friendly has fairly stringent protocols for determining the eligibility of carbon offsets produced from forests (including a financial additionality test). While

¹ National Electricity Market Management Company Limited

² Independent Market Operator

these protocols might be debated to ensure they maximise efficiency over time (including the potential fungibility with other international trading schemes), Griffin believes it is prudent to begin with restrictive regulations that may be loosened over time. This accords with the important principle raised in section 3.1 relating to the requirement for strict standards and scheme integrity.

3.4 National register for offsets and early action credits

Griffin agrees that a register should be developed to track all transactions of offsets and early action credits. The sooner this is accomplished the better, as a greater level of understanding of the impending trading scheme will filter into the market.

3.3 Transitioning early action credits into the emissions trading scheme

Early action abatement should be encouraged. Early action credits should be tradable prior to caps being introduced and credits for early action should cease after the introduction of an ETS (as the benefit of the early action abatement is now realised through the reduced emission liability resulting from the earlier abatement). How early action credits might be recognised once an ETS is introduced presents several issues. The Task Group paper suggests that each early action credit be exchanged for an emissions permit dated for use in the first year of the scheme. Depending on the actual start date of an ETS, there may be several years of early action credits built up, each requiring to be exchanged for an emissions permit. This must be achieved without breaching the integrity of the cap. Griffin believes that if early action credits are to be exchanged for emissions permits, then the permits they are exchanged for should come out of the quota allocated for auction, rather than affect the allocation of permits to existing assets. It can be deemed as the price paid by government for incentivising early action. This assumes that the number of permits set aside for auction is greater than the number of early action credits built up by year one of an ETS. If this is not the case, then Griffin suggests a staggered exchange of early action credits with emissions permits over the initial years of an ETS.

A second issue surrounding the exchange of early action credits with emissions permits is the limitations proposed on the banking of these permits for use in subsequent years. If, as is likely in the early years of an ETS, the 'emission fee' is set at a low figure (capping the value of permits), then there is a likelihood that many of the early action credits will have cost more to produce than their subsequent permits will realise in a market. This could have the impact of disincentivising early action abatement³. What constitutes a 'low' value for an emission fee is an interesting question. The value of any cap on permits is somewhat arbitrary. Some permits (from early action abatement) might have cost more to produce and some might have cost less. A short-term arbitrary cap may affect the value of efficient longer-term early action abatement. Griffin suggests that the Task Group consider allowing the date of transfer of early action credits to emissions permits be left up to the holder of the verified early action credits. It will be in the best interests of the holder to maximise the value of that credit relative to that holder.

³ This is especially true when such uncertainty around the level of the emissions fee prevails.

While there is justification for limiting the banking of *permits* (i.e. if the emissions fee is set, then auctioned permits should never cost more nor trade for higher than the emissions fee⁴), there should be no limit on the banking of *offsets*, whether created through early action abatement or not. Griffin believes that offsets created at a higher cost than the cap placed on permits by an emissions fee should be able to be banked and used at some later date, when the price cap on permits increases (or disappears altogether). This will ensure that efficient, long-term offset projects can proceed without risks of early financial losses.

Griffin understands that the consultation process required to implement an ETS will take some time and will require interactive engagement between government and industry. Griffin is happy to continue to be part of this process and looks forward to the outcome of the current discussion paper.

Should you have any questions regarding our comments, please contact:
Shane Cremin, Market Development Manager, Griffin Energy, 08 9261 2908.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'W. Trumble', with a horizontal line drawn underneath the signature.

Wayne Trumble
EGM Power Generation

⁴ There may exist a small premium on the price of a permit over the emission fee based on the reputational effect of acquitting a permit over being levied a penalty.