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Climate Change Group  
Department of the Prime Minister and Cabinet

By email: [emissionstrading@pmc.gov.au](mailto:emissionstrading@pmc.gov.au)

The Energy Supply Association of Australia (esaa) welcomes the opportunity to comment on the 'Abatement Incentives Prior to the Commencement of the Australian Emissions Trading Scheme' discussion paper.

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 Association fully supports the two policy objectives for early abatement incentives described in the discussion paper:

- to ensure firms do not have perverse incentives to cease undertaking abatement opportunities that are currently cost effective in the lead up to the implementation of emissions trading; and
- to provide incentives to bring forward additional abatement by providing an advance linkage with the future scheme.

Removing potential perverse incentives to delay cost effective abatement is important to facilitate least cost abatement. The commitment to ensure an entity will not be disadvantaged for undertaking abatement after the date that the Australian Government announced that an Australian Emissions Trading Scheme (AETS) would be implemented is critical to removing any perceived or actual incentive to delay abatement activities until permit allocation and/or compensation processes are finalised.

Setting an entity's baseline emissions, and/or energy use, as early as practical will remove any potential incentives to delay abatement, and will allow the incentive to reduce liabilities ahead of imminent introduction of a price on carbon to flow to all firms. The history of proactive engagement by the energy industry with greenhouse issues, and the plethora of existing federal and state programs for greenhouse management, means that many assets in the energy sector will have robust, verifiable emissions and energy data for several years prior to the introduction of mandatory reporting. To enhance the approach suggested in the discussion paper, entities who can demonstrate they have sufficiently robust baseline data should be able to opt to use a baseline year coinciding

with the announcement that an AETS would be implemented (06-07), rather than the first mandatory reporting year (08-09).

esaa supports in principle the proposed method for providing positive incentives for early abatement ahead of the introduction of an AETS. Linking early abatement and offset credits directly to emissions permits has the advantage of providing incentives for additional early abatement, while recognising the centrality of the AETS and avoiding adding unnecessarily to the plethora of existing and proposed regulatory measures targeting greenhouse abatement. However, it will be difficult for firms to put a value on the early abatement or offset credits until the Government provides further detail regarding the emissions cap and likely permit prices. To enable the early abatement incentives to function effectively it will be important to inform the market about carbon caps and trajectories, and finalise robust but efficient project approval processes as soon as practical.

Taxation issues related to the establishment and operation of an AETS were not discussed in the paper. However, the creation of tradeable early abatement certificates that will transition into emission permits under an AETS will bring forward many of the taxation issues associated with the introduction of emissions trading. To ensure that the tax system does not introduce unintended distortions, or otherwise impede efficient emissions abatement, consultation in relation to taxation issues should commence as soon as practical.

In addition to the general points made above, more detailed commentary has been provided on selected sections of the discussion paper below.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Brad Page', with a stylized, cursive script.

**Brad Page**  
Chief Executive Officer

## Specific comments

### Section 2.1 No Disadvantage Arrangements

esaa fully supports the principle that firms who undertake abatement between the date that the Government announced that an AETS would be implemented and the actual implementation date should not be disadvantaged. This commitment is critical to remove any potential or perceived perverse incentives to delay abatement, and allows the positive incentive to abate emissions in the knowledge of the imminent introduction of a price on carbon to flow to all firms.

The approach proposed in the discussion paper, to set an entity's energy use and emission baseline as soon as practical, is highly desirable. It should be noted that although the discussion paper refers to an 'emissions baseline' and 'emissions abatement', the form of compensation generally proposed for trade exposed, emissions intensive (TEEI) firms involves subsidising expected increases in energy costs as well as direct emissions<sup>1</sup>. In the event that the Government does elect to subsidise increased energy costs for TEEI's that arise from the introduction of an AETS, the 'energy baseline' will be more material for no disadvantage arrangements than direct emissions for many TEEI firms.

Once the energy and/or emissions baseline has been set for a firm, any perverse incentives to delay abatement are removed and the positive incentive to reduce direct emissions and/or energy use will flow directly to all firms to minimise exposure to cost increases associated with an AETS.

The discussion paper proposes that the 2008-09 year will be used as the baseline year, in combination with verified emissions data from 07-08. This approach is proposed as 2008-09 is the first year of national mandatory reporting under the new National Greenhouse and Energy Reporting System (NGERS). This approach is appropriate for firms lacking robust, verified (or verifiable) data for the optimal baseline year, which would generally be the 06-07 financial year given the 'no disadvantage' commitment commences on 3 June 2007.

However, many entities will be in a position to provide robust, externally verified, or verifiable, energy and/or emissions data for the 06-07 year, using energy bills and greenhouse emissions estimated using robust methods developed or approved by the Australian Greenhouse Office (AGO) for the Greenhouse Challenge Plus program and the various mandatory programs in place in several states.

Where entities have robust, verifiable baselines for the 06-07 year, they should be able to opt to have that year approved by the scheme regulator as the baseline year.

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<sup>1</sup> 'Possible Design for a National Greenhouse Gas Emissions Trading Scheme, NETT August 2006; and 'Report of the Task Group on Emissions Trading', Prime Ministerial Task Group on Emissions Trading, May 2007

Before baseline data can be finalised for any given year, final and precise definitions will be required for facility boundaries, liable entities, and TEEI's eligible for compensation. It is not clear at this stage that NGERS reporting requirements will directly align with the needs of the AETS either for ongoing reporting of liable emissions, or the reporting of baselines calculated using the defined boundaries of the facilities and entities that may be eligible for compensation.

## **Section 2.2 Assets Eligible for Compensation**

The definition of an asset that was 'committed' as at 3 June 2007, should be determined on the specific facts of each project. It is unlikely that there will be a large number of projects whose 'existence' is in doubt on 3 June 2007. However the determination may be highly material for an individual project and a definition should be drafted specifically for this purpose. The test should look to the financial commitment – that is the sunk costs paid or committed in contractual and other arrangements – and other legally binding commitments that make it unviable or impractical to not proceed to completion.

The definition of a committed project used by the National Electricity Market Management Company (NEMMCO) for generation and provided in the discussion paper is indicative of the issues that should be considered, however it was developed for planning purposes and may unfairly discriminate against some projects if used directly for the purpose of determining eligibility for compensation.

The NEMMCO definition was designed to support the integrity of the Statement of Opportunities, by allowing a more accurate forecast of future electricity supply and demand, as there is a very high likelihood that a 'committed project' will be completed. The 'committed project' classification also achieves a secondary role, which is to provide investors with an array of projects within which to invest<sup>2</sup>.

The definition of 'committed' for the purpose of determining eligibility for compensation should be less constricting than the NEMMCO definition and focus on the specific circumstances of each project. It is conceivable that a project could be fully committed commercially without meeting all of the criteria in the NEMMCO definition, and there may be circumstances where other criteria are more relevant.

For example, a gas transmission pipeline project may be fully committed and under construction without having all planning or environmental approvals that may be required for every specific area or facility. Land acquisition may not always be required for energy distribution projects as they generally have a right of access to put infrastructure in or above roadways. Conversely a project which meets all the criteria in the NEMMCO generation definition may have sufficient flexibility in their specific contractual arrangements that make it practical to defer or cancel the project.

It is also worth noting that NEMMCO uses a different definition for transmission projects<sup>3</sup>.

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<sup>2</sup> Review of NEMMCO's Statement of Opportunities: PricewaterhouseCoopers, August 2001.

<sup>3</sup> NEMMCO Statement of Opportunities: 2007 : 'to be committed, regulated transmission augmentations must satisfy all of the following criteria: Board commitment has been achieved; Funding has been approved; The project has satisfied the Regulatory Test Construction has either commenced or a firm date has been set

### **Section 3 Positive Incentives to Undertake Additional Abatement**

esaa supports in principle the general approach proposed in the discussion paper to provide positive incentives for early abatement through the creation of tradeable credits that will transfer directly into emission permits under the AETS. The Association has long advocated that a well designed emissions trading system must be the central policy mechanism to achieve least cost emissions reduction. The proposed approach recognises the centrality of the AETS and should facilitate some additional abatement ahead of the introduction of emissions trading, without unnecessarily adding to the plethora existing and proposed regulatory measures that nominally target greenhouse abatement.

The AETS is a significant economic measure. It is important that the overall design and the setting of specific targets are based on sufficient analysis to ensure efficient outcomes. This necessarily takes time, and the proposed incentives will help to ensure some of the benefits of an emissions trading system are brought forward, and facilitate early price discovery.

However, it will be difficult for firms to put a value on the early abatement or offset credits until the Government provides further detail regarding the emissions cap and likely permit prices. To enable early abatement incentives to function effectively it will be important to inform the market about carbon caps and trajectories, and finalise robust but efficient project approval processes as soon as practical.

While the three year timeframe between now and the planned commencement of the AETS in 2010 may appear lengthy to some members of the community, it is a relatively short time to bring forward the sort of large scale investment that is likely to be required to deliver significant abatement. esaa agrees it is unlikely that the volume of early abatement credits will be large relative to the scale of Australia's emissions.

It is important to note that the introduction of early abatement incentives will bring forward some of the key taxation issues that will need to be addressed to achieve the desired 'tax neutrality'<sup>4</sup> and ensure tax treatment does not perversely impede the policy intention of encouraging abatement. Consultation regarding taxation issues more generally, and specifically related to early incentive credits, should commence as soon as practical. Key issues will include the income tax treatment in relation to costs and revenues associated with creating, holding and disposing of certificates, and the indirect tax treatment in relation to certificates (particularly GST and Stamp Duty).

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for it to commence. All other transmission projects (those projects that need not satisfy the Regulatory Test) must satisfy all of the criteria for 'Committed projects - generation'.

<sup>4</sup> 'Report of the Task Group on Emissions Trading'; Prime Ministerial Task Group on Emissions Trading 2007 pg113

## **Section 3.2 Eligible activities**

To protect the integrity of the AETS it is important that there is robust validation of the additionality and quantum of early abatement certificates and offsets. As noted in the paper, the imminent introduction of the AETS will provide direct incentives to reduce emissions and energy use within the covered sectors, particularly once baselines are set. However, administrative procedures will need to be as clear, timely and efficient as possible to facilitate legitimate early abatement project. Robust and efficient project approval processes should be finalised as soon as practical.

There should be no cap on the volume of early abatement credits, as there is no sensible policy reason to limit the amount of cost effective abatement that can be achieved before the introduction of an AETS – provided the early abatement is real.

Imputed future abatement beyond the commencement of the AETS should not be recognised as early abatement, as future emissions reductions or improved energy efficiency will have direct incentives under the AETS on commencement.

Proposed abatement projects should be required to choose between creating certificates under this proposed system, and participating in incentives under other schemes (eg GGAS), as adding incentives from multiple schemes will distort the financial assessment of abatement costs.

## **Section 3.3 Administrative Arrangement**

The existing framework developed for the Greenhouse Friendly program should be used and streamline with the NGERS. However, use of existing program infrastructure and streamlining should not occur where this would compromise the integrity, transparency or complexity of the AETS and the early abatement incentives. The systems and processes for the Greenhouse Friendly program will need to be streamlined and improved to efficiently support the registration and administration of early abatement and offset certificates.

## **Section 3.4 National Register for Offsets**

A national offset register should be created to track early action credits and offsets as early as practical. The information in the register should be updated as close to real time as practical and provided publicly to the market.

## **Section 3.6 Transitioning early action credits into the ETS**

As noted above, esaa supports in principle the proposal to make early action credits directly exchangeable for emissions permits. Provided the abatement is real and additional there is no justification for limiting the number of early abatement credits that can be created.

The number of early action credits created should be considered in the final setting of an emissions cap under the AETS. However it is unlikely that a large enough volume of real additional abatement would be able to be created within the relatively short period between the creation of the incentive scheme and the introduction of the AETS to have a material impact on the national cap.

### **Section 3.8 Voluntary market access to offsets accredited in the ETS**

Voluntary markets should have access to early abatement credits.