AGL Energy Limited
ABN: 74 115 061 375

Level 22, 101 Miller St
North Sydney NSW 2060

Locked Bag 1837
St Leonards NSW 2065

T: 02 9921 2999
F: 02 9921 2552
www.agl.com.au

SUBMISSION 10

Committee Secretary

Standing Committee on Economics

PO Box 6021

Parliament House

CANBERRA ACT 2600

AUSTRALIA

26 September 2012

Sent via email to economics.reps@aph.gov.au

Dear Committee Secretariat,

AGL Energy (AGL) welcomes the opportunity to make a submission to the House of Representatives Economic Committee Review of the *Clean Energy Amendment (International Emissions Trading and other Measures) Bill 2012 and Six Associated Bills*.

AGL is Australia's leading renewable energy company with the largest privately owned/operated renewable portfolio. AGL is also one Australia's largest retailers of gas and electricity with over 3 million customers in Victoria, New South Wales, South Australia and Queensland. AGL operates across the supply chain with investments in energy retailing, coal-fired electricity generation, gas-fired electricity generation, renewables and upstream gas extraction. Under the carbon pricing mechanism, AGL anticipates being one of the largest liable entities for 2013.

AGL cautiously supports the introduction of one-way linking to the EU ETS to address the administrative difficulties of a domestic floor price. In amending the Act to give effect to this change, AGL urges caution with respect to setting regulatory capacity to significantly impact the value of units. However, the Draft Amendments with respect to natural gas coverage are not supported. The case for their necessity has not been made, and AGL recommends as a minimum the first compliance year is completed prior to reviewing any perceived coverage issues of this sector.

For further detail, please refer to AGL's submission on the draft Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012 and related bills (attached).

Yours sincerely,

Tim Nelson

Head of Economic Policy

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ABN: 74 115 061 375

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SUBMISSION 10

A few words.

Clean Energy Future Consultation

Department of Climate Change and Energy Efficiency

Email – ce.regulations@climatechange.gov.au

6 September 2012

Dear Madam/Sir,

Re: Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012 and related bills

AGL Energy wishes to provide comment on the Exposure Draft Clean Energy Legislation Amendment (International Emissions Trading and Other Measures) Bill 2012 and related bills (the Draft Amendments).

AGL Energy (AGL) is Australia's leading renewable energy company with the largest privately owned/operated renewable portfolio. AGL is also one Australia's largest retailers of gas and electricity with over 3 million customers in Victoria, New South Wales, South Australia and Queensland. AGL operates across the supply chain with investments in energy retailing, coal-fired electricity generation, gas-fired electricity generation, renewables and upstream gas extraction. Under the carbon pricing mechanism, AGL anticipates being one of the largest liable entities for 2013.

The Draft Amendments released for comment on Friday 31 August 2012 are significant, and the limited timeframe offered for such important changes to the Clean Energy Act 2011 (the Act) establishes a worrying precedent for investors in stationary energy supply. Suggesting less than 5 working days are available to scrutinise and comment is not considered appropriate. In this submission, AGL considers the approach taken to address the legislated floor price through proposed linking to the European Union Emissions Trading Scheme and the proposed changes to natural gas liability.

Proposed linking to the European Union Emissions Trading Scheme

Consultation on administration of the legislated floor price earlier in 2012 demonstrated the difficulties in setting a minimum domestic price in a market with international linking. AGL was concerned that implementation would; result in higher and unpredictable transaction costs for liable entities; hinder market development; and impede investment in clean development projects.

AGL supports the development of a domestic carbon market. This is required to facilitate forward contracting of associated commodities including electricity and natural gas as well as to promote least-cost abatement. The development of a liquid domestic carbon market has not yet occurred in-part due regulatory uncertainty surrounding administration of the floor price mechanism. For these reasons, AGL is cautiously optimistic that the proposed linking to the EU ETS is a positive development.

With respect to the Draft Amendments, AGL considers s48E should be further defined in the capacity of regulations to govern Australian-issued international units. Current drafting suggests regulations could impact such units significantly in terms of eligibility and therefore value. Further definition should also be extended to s66A.

AGL notes that s123A introduces regulatory powers that will create uncertainty, which could impact investment in low-emission projects and increase costs for compliance. Providing powers for regulations to alter designated limits, particularly in timeframes that are not aligned with investment in low-emission clean development projects will result in investors applying greater risk premiums. Furthermore, changes to the designated limits of specified eligible international emissions units in timeframes that are not aligned to secondary carbon market and commercial contracting periods could result in liable entities having to implement a more costly, risk adverse carbon management strategy. If such provisions are to persist, AGL recommends grandfathering-type treatment is legislated, to allow investments made in good faith to not be impeded by high regulatory risk. For example, anyone who purchased CERs to a volume of 50% of their forecast FY16 liability based on the current legislation could be able to surrender them, even though this draft legislation repeals the current subsection 133(7) and is intended to reduce the volume of Kyoto units allowed to 12.5%.

Finally, the "place holder" nature of some provisions, particularly around the possible machinations of linking cross-border registries is a case in point, that there is risk of unintended consequences. AGL is supportive of steps towards the development of a robust domestic carbon market and considers the proposed linking a progressive step, provided there is a sufficient balance between regulatory oversight and allowance of liable entities to confidently hedge their carbon costs.

Liability arising from the supply of natural gas

AGL does not support the Draft Amendments relating to the incidence of liability for natural gas supply. These changes to the already complex gas supplier provisions of the Clean Energy Act 2011 (the Act) will introduce significant new obligations for natural gas suppliers, including the development of new systems, processes and capabilities, and as they are currently drafted, may prove impossible to comply with. Furthermore, the need for these amendments is yet to be established, as it appears that the coverage of natural gas by the carbon price mechanism is near complete. Much of the detail around if and how the legislative changes would be implemented will be determined by future regulations. AGL recommends that until the need for, and details of such changes are established, these sections of the Draft Amendments should be removed.

<u>Coverage of Natural Gas under the Carbon Price Mechanism</u>

AGL understands that the intended purpose of the Draft Amendments relating to natural gas supply is to increase the coverage of the carbon price mechanism on gas supplies, to better achieve the goal of complete coverage, to support competitive neutrality in the sector.

Under the Act and associated regulatory framework, a small number of natural gas supply arrangements will not attract a carbon price liability under any of the natural gas supplier (section 33 of the Act), Obligation Transfer Number (OTN) (section 35 of the Act), or direct emitter (sections 20 – 25 of the Act) provisions. These may include situations where a natural gas supplier does not 'ascertain' the volume of gas withdrawn from a natural gas supply pipeline, such as:

- Where there is no change of ownership of the gas between the natural gas producer and the end user of the gas (i.e. the user and producer of the gas are the same person, so there is no 'supply' of gas);
- Where an end user of natural gas procures gas directly from a wholesale gas market (i.e. the end user is the market participant). If the end user's facility has annual covered greenhouse gas emissions of less than 25,000 tCO2e, the emissions from the combustion of natural gas would not attract a liability for either the natural gas supplier (as there is no clear supplier in the wholesale market), nor the end user;
- Where an end user of natural gas procures gas from a supplier at a delivery point upstream from the facility where the gas is ultimately used (and the user then arranges

transport of the gas from the delivery point to the facility). If the end user's facility has annual covered greenhouse gas emissions of less than 25,000 tCO2e, the emissions from the combustion of natural gas would not attract a liability for either the natural gas supplier, or the end user.

AGL considers these scenarios to be most unusual. Typically, if an end user enters into a commercial arrangement to procure gas either directly through a wholesale market, or from a supplier through a wholesale contract, their gas use will be very high (and much higher than the 487 TJ of gas combustion that is required to trigger the annual covered emissions threshold of 25,000 tCO_2e). Participating directly in a wholesale market involves a high set up cost (to cover accreditation, bank guarantees, systems required to communicate with the market operator etc), as well as ongoing personnel requirements to participate in the market, and exposure to a volatile wholesale gas price which carries with it significant risk (valued at potentially much more than any avoided carbon liability — the maximum market price is $800 per GJ in the Declared Wholesale Gas Market in Victoria and $400 per GJ in the STTM). Similarly, managing a gas transportation agreement and a direct relationship with a gas wholesaler can also be onerous in that they require specific expertise, systems, and ongoing requirements for daily gas nominations, supply of system use gas to pipeline operators, etc. If gas is not a major input into an end user's production or process, AGL considers that it is very unlikely that the user would elect to enter into such an arrangement, given the investment of time, effort and resources required. In other words, the costs associated with amending supply arrangements to avoid liability under the carbon price would be significantly greater than any benefits from avoided liability.

AGL considers that the existing coverage of natural gas supply under the carbon pricing mechanism is very near complete, and that the related Draft Amendments are not required at this time. Furthermore, AGL considers that any coverage gaps are unlikely to prompt consumers (in a material way) to alter their gas supply arrangements so as to avoid carbon price liability, given the increased responsibilities and risks associated with wholesale supply and wholesale market arrangements. Should incomplete coverage and/or leakage of natural gas supplier liability prove to be an issue in future (which should be fairly evident once data for at least one compliance period becomes available), amendments to the Act could be considered at that time, and drafted in a more specific and targeted manner.

If the Department of Climate Change and Energy Efficiency (DCCEE) is concerned about the existence of incentives to restructure gas supply arrangements to avoid liability, AGL suggests that it may be simpler to add additional anti-avoidance provisions to section 29 of the Act to address such as eventuality, rather than the lengthy Draft Amendments as they are proposed.

Definitions of key terms

Sections 5A and 6 of the Draft Amendments provide for important definitions relating to the supply of natural gas (and the associated liability under the carbon price mechanism) to be made or changed in future Clean Energy Regulations. These definitions, for 'natural gas supply' (and the associated definitions of natural gas supplier and when natural gas supply occurs), are critical to the establishment and determination of gas supplier liability. AGL understands that the intent of these Draft Amendments is to provide options for the coverage of atypical gas supply arrangements (such as those noted above), however, as the amendments are drafted, there are no limits on the changes to these definitions that could subsequently be introduced. AGL believes that given the materiality of the consequences of amending definitions under the Act, it is appropriate that this be achieved by legislation rather than sub-ordinate legislative instruments.

AGL considers that in principle, changes to critical components of the carbon price mechanism (or potential changes) should only be made in the Act, rather than the supporting regulation.

Incidence of liability and own-use notifications

The Draft Amendments introduce new concepts to enable liability to arise in relation to gas supplies where the existing provisions in the Act do not produce a liability for any party for the combustion of the gas. These include the 'own use notification' which would presumably operate in a similar manner to the existing OTN provisions, to transfer liability for potential emissions embodied in a supply of natural gas between the supplier and recipient. AGL notes that much of the detail concerning the intended operation of the own-use notification process is yet to be determined by future regulations. Such unresolved details include; where the responsibility would sit to identify a relevant supply; whether the liability for such a supply would default to the supplier or recipient; and whether the acceptance of an own-use notification would be voluntary or mandatory. AGL recommends that these amendments be removed until this uncertainty is resolved.

In particular, AGL considers the proposed section 35A to be unsuitable as it is currently drafted, as it is a 'catch-all' provision for any and all gas supplies not covered by the existing legislation. This section implies that a natural gas supplier may be considered liable for the potential greenhouse gas emissions embodied in the provision of a volume of natural gas, if no liability exists elsewhere in the supply chain for those emissions. No qualification has been included to acknowledge that natural gas suppliers would generally be unable to comply with these requirements, since suppliers would not typically have access to relevant information. For example:

- Natural gas suppliers have no means to determine whether a customer's facility will trigger the threshold for the direct emitter provisions in sections 20-25 of the Clean Energy Act 2011;
- Natural gas suppliers would generally not have access to data used to determine the volume of natural gas being withdrawn from the natural gas supply pipeline in such circumstances, and therefore would have no basis on which to determine the associated liability (particularly if liability were only to arise for part of a supply of natural gas).

Any additional natural gas supplier liability (beyond the provisions of section 33 of the Act) must be predicated upon the supplier receiving a suitable notification specifying the liable supply, and the ongoing provision of suitable information upon which the supplier can determine and acquit the associated liability (otherwise it would be impossible for natural gas suppliers to meet their compliance obligations). If the draft section 35A is to remain, it is essential to clarify that a liability for a gas supplier under this section would only arise upon receipt of an appropriate own-use notification. AGL considers that should the unusual gas supply arrangements in question result in a liability, this liability should default to either the recipient or user of the natural gas, as these are the only parties that would have the ability to determine the associated liability – especially if part of the gas is on-supplied or used as a feedstock. The provision of own-use notifications, and their acceptance by natural gas suppliers should be voluntary, with suppliers having the option to decline the liability if the recipient is unwilling or unable to provide the required data in an acceptable timeframe and format.

<u>Measurement of natural gas supplier liability</u>

The Draft Amendments include proposed changes to the National Greenhouse and Energy Reporting (NGER) Act 2007, enabling the Minister to introduce a legislative instrument concerning the measurement of natural gas supply volumes (to apply no earlier than 1 July 2013). These Draft Amendments would also allow for legislative instruments to adjust previous years' provisional emission numbers in relation to the supply of natural gas in certain situations, such as revisions to supply volume data.

AGL welcomes the recognition that natural gas supply volumes are subject to revisions over time, which has implications for establishing the liability of natural gas suppliers. AGL considers that the related conditions (yet to be specified in a future determination) should

include an appropriate materiality threshold, so that only amendments above a certain level require amendments to a provisional emissions number and potentially the resubmission of NGER reports (to avoid the requirement for most gas suppliers to resubmit their NGER reports each year on the basis of minor data revisions, which are very common). The process could also be streamlined by rolling-over any adjustments to provisional emissions numbers into the following compliance year to avoid resubmission of NGER reports altogether (along with the roll-over of any surplus or deficit in surrendered carbon units). It should also be clarified that any such changes requiring an amendment to a provisional emissions number on the basis of data revision would not be considered non-compliances, and that no penalties or shortfall charges would apply.

Conclusion

AGL cautiously supports the introduction of one-way linking to the EU ETS to address the administrative difficulties of a domestic floor price. In amending the Act to give effect to this change, AGL urges caution with respect to setting regulatory capacity to significantly impact the value of units. However, the Draft Amendments with respect to natural gas coverage are not supported. The case for their necessity has not been made, and AGL recommends as a minimum the first compliance year is completed prior to reviewing any perceived coverage issues of this sector.

Yours sincerely,

Simon Kelley
Head of Carbon Implementation