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Dear Professor Garnaut

**Energy Developments Limited (EDL)
Garnaut Climate Change Review Emissions Trading Scheme Discussion Paper
EDL Submission to ETS Discussion Paper**

EDL thanks the Garnaut Climate Change Review for the opportunity to comment on the Discussion Paper and certain aspects of the proposed Emissions Trading Scheme.

EDL's Background

By way of background, EDL is an international provider of independent, renewable and low greenhouse gas (**GHG**) emission energy. EDL operates in Australia, the United Kingdom, Europe and the United States, providing services in four main areas of power generation and associated energy solutions:

- Landfill gas (**LFG**) power;
- Coal mine methane (**CMM**) power;
- Remote area power; and
- Liquefied natural gas (**LNG**) and compressed natural gas (**CNG**) power.

EDL owns various power generation facilities internationally and, has a total installed generation capacity of approximately 547 MW. EDL is one of Australia's largest carbon abaters, capturing and utilising approximately 8.5 million tonnes of GHG CO2 equivalent from its LFG and CMM power generation projects around the world in the financial year ended 30 June 2007.

EDL generates revenue from:

- Providing and selling low emission electricity to direct customers such as large energy retailers and mining companies;
- Generating and selling environmental credits in international, national and state based schemes; and
- Managing LFG related infrastructure on behalf of landfill owners.



EDL abates significant quantities of Australian GHG

EDL is a significant player in the Australian GHG abatement scheme, and was an early mover in GHG abatement activities. EDL has seen GHG abatement activities flourish under the NSW Greenhouse Gas Abatement Scheme (**GGAS**), with the market for New South Wales Greenhouse Gas Abatement Certificates (**NGAC**) supporting this important activity, albeit that the NGAC market has recently been adversely affected by a number of factors, including, regrettably, previous Emissions Trading Scheme announcements.

As an early mover in GHG abatement activities, EDL would be concerned should the ETS fail to properly take account of existing projects and existing abatement and the GGAS support for these projects, in such a way as to effectively penalise market players with the foresight and vision to engage in pre-ETS GHG abatement or provide a perverse incentive to discontinue existing abatement activity, which in turn reduces displacement of high GHG electricity generation and consequently increases GHG emissions.

Summary of EDL's Position on the ETS

In summary, EDL broadly supports an ETS, provided it:

- is appropriately framed to support early movers in GHG abatement activities; and
- does not provide a perverse incentive to discontinue existing abatement activity (and therefore increase GHG emissions) of existing GHG abatement electricity generators.

EDL considers that support for early movers in GHG abatement activities needs to include:

- compensation for the loss of support from GGAS; and
- full electricity carbon cost pass through mechanisms so that the ultimate cost of the ETS to GHG abatement electricity generators is passed through to end user consumers, and not left to burden GHG abatement electricity generators.

The ETS should not be environmentally ineffective and increase GHG emissions

EDL's principal concern is that the future detailed design features of an ETS do not unintentionally penalise:

- the environmentally beneficial activity of turning waste methane into power; or
- early mover GHG abatement electricity generators which have undertaken capital intensive long term arrangements ahead of and without contemplation of an ETS.

EDL is an **early mover GHG abatement electricity generator**, providing independent, renewable and low GHG emission energy in Australia and abroad. Through LFG and CMM electricity generation, EDL's activities result in significant reductions in net greenhouse emissions by:

- converting the methane to less polluting carbon dioxide, and generating electricity in the process; and
- displacing coal fired electricity generation and offsetting the demand for emissions intensive power within the economy.

Without careful consideration of aspects of an ETS's design, there is the potential for EDL to suffer unfair disadvantage as a consequence of a poorly designed ETS. Such disadvantage may lead the ETS to impact in a manner that is both environmentally ineffective and, in as much as an ETS aims to correct a market failure, economically inefficient.

EDL is concerned that under certain conditions a poorly designed ETS may cause CMM and LFG waste to energy services to be penalised in a manner that is disproportionate to the environmental benefit they provide, and which may cause an increase in GHG emissions. A poorly designed ETS could lead to the closure of CMM and LFG energy generating facilities, leading to a perverse environmental outcome.

EDL CMM and LFG waste to generation facilities may suffer a multiple loss from:

- the imposition of a new permit liability;
- the loss of ability to generate an income credit from the environmental benefit of greenhouse gas abatement;
- constraints in the ability to pass through new permit liability to electricity purchasers (and through them to the appropriate party, the ultimate electricity end user) due to the pre-ETS environment in which capital intensive long term early mover GHG abatement electricity generation projects have been executed.

The cumulative impact of a range of emissions policy changes could make it difficult for companies such as EDL to continue these greenhouse gas reduction activities, that are amongst the most cost effective forms of abatement.

Appropriate treatment of early mover GHG abatement electricity generators

The unique aspects of and circumstances applicable to early mover GHG abatement electricity generators warrant special treatment of these generators (separate from fossil fuelled generators) on equitable grounds and to preserve the efficient operation of an ETS in facilitating GHG reductions. The hallmarks of early mover GHG abatement electricity generation projects include:

- fixed price long term offtake arrangements with:-
 1. no, limited or unclear mechanisms to pass through ETS carbon costs; and
 2. no ability to renegotiate tariffs to have an increased electricity price to ameliorate the loss of 'offset certificate production' revenue; and
- reliance upon GGAS and similar mechanisms.

In relation to the first point, it is inconsistent with the Discussion Paper conclusions that the cost of meeting the emissions trajectory would be borne by electricity consumers (on a polluter pays principle), for early mover GHG abatement electricity generation projects to have no mandated electricity carbon cost pass through mechanisms enshrined in the ETS legislation. It also leaves retailers (who are the offtakers) making windfall gains as they demand and receive higher retail electricity prices taking account of carbon costs, but fail to pass these revenue streams onto the generators.

Of course, in the unlikely event that such a retailer were to be constrained in its ability to pass through carbon ETS costs, then EDL would be supportive of a similar cost pass through mechanism applying for the retailer. However, EDL notes that it would be unlikely for a retailer to be in such a position given that, while electricity generation sale contracts have traditionally been long dated, the same is not the case for retail electricity sale, which invariably have a shorter duration.

Further, the Discussion Paper concludes in favour of protections for TEEIs on the basis that they are largely "price takers". The same convincing rationale for protecting TEEIs also applies to early mover GHG abatement electricity generation projects.

Whilst EDL understands the environmental and economic arguments posed in the Discussion Paper against the compensation of fossil fuelled generators, a distinction needs to be drawn between different classes of generating assets.

Positioning fossil fuelled generators and early mover GHG abatement electricity generation projects in the same class of asset neglects to take into account and reward the environmental benefit of the latter.

In relation to the second point, if the ETS is to overturn the GHG incentives inherent in GGAS, then reliant early mover GHG abatement electricity generation projects require compensation on equitable grounds, having been based on, relied upon, and supported by such schemes.

For these reasons, we believe that any protections or concessions that may be awarded to TEEII's be also fairly extended to early movers such as ourselves.

The consequence of an ETS ignoring such unique aspects of and circumstances would be to have an ETS that is environmentally ineffective and economically inefficient in its support for low cost abatement.

We would also like to point out the ramifications from a policy perspective.

Amongst all the uncertainty, one thing is clear - the market will continue to change and develop as the carbon debate matures. Managing this process of change will be a difficult task. However we must keep in mind the ultimate goal – to reduce emissions.

If we are to ensure that the investment in GHG reduction projects is to be continued, the investment community must have the belief that when the rules do change appropriate consideration and if necessary compensation, is given to existing participants – in particular they will not be left holding an asset that has suffered a significant diminution in value as a consequence of that regulatory change. An effective treatment of pre ETS abatement projects on an equitable basis would be the first step in providing this confidence.

As such the ETS scheme designers must protect early movers who have committed projects, under GGAS or otherwise.

OTHER MATTERS IN SCHEME DESIGN

Emissions trajectory

EDL is supportive of an appropriately “steep” emissions trajectory and EDL recognises the environmental and economic advantages over the longer term of an emissions trajectory that leads to greater reductions in the shorter term.

Sectoral coverage

EDL generally supports the coverage of the sectors and gases proposed in the Discussion Paper. EDL considers there is a clear need to limit the point of obligation to the initial source of the emissions and not to the generator. Where such limitations are not imposed, compensation should be made available to the generators.

EDL considers that waste should not be a covered sector on the basis that:

- it is not possible to accurately measure or create default emission factors as the composition of each and every landfill is different; and

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- waste is not a 'covered' sector under international agreements and consistency with this approach will assist linkage.

Auctioning

On the basis that fair and appropriate compensation is made to early mover GHG abatement electricity generation projects, EDL considers that

1. Auctioning provides the fairest method of setting the price of carbon permits, provided that the auctioning mechanism results in permits being the same price for all participants. The reverse auctioning system employed in the National Electricity Market for interregional settlement residues is an example of such an auctioning system. All participants wishing to participate in this auction submit their bid for the desired quantity. The clearing price is set by the lowest bid required to take up the total allocations on offer; and
2. There should be no free allocation to the generation sector in Australia (other than the early mover GHG abatement electricity generation sub-sector) as all power stations should compete on an equal emissions basis. Grandfathering permits to high emission power stations disadvantages those organisations who have invested in higher cost but lower emission generation technology.

Banking

EDL is supportive of ETS banking as it has worked well to assist companies manage liabilities from year to year, particularly when the target is increasing as it is expected to do so in the Australian Emissions Trading Scheme. Banking has not impacted forward markets.

Borrowing

EDL is not supportive of borrowing. EDL considers that borrowing will have a negative impact on the market by reducing transparency around the availability of permits within the scheme, and impacting negatively on demand and supply. EDL also considers that borrowing will likely have a negative impact on the forward markets. Companies choosing to defer liability through borrowing are likely to drive prices higher in future years than otherwise would have been the case.

Borrowing also:

- delays investment in low emission infrastructure, which is not consistent with the environmental intent of an emissions trading scheme.
- introduces solvency risk into the ETS: the risk that an entity will pollute today, borrow against the future and become insolvent with no means of "repaying" the carbon debt.

Offsets

EDL is supportive of the unlimited inclusion of offsets from non-covered sectors.

We would like to reiterate that, if fugitive methane from the waste and coal mine sectors were to be covered under the ETS, then EDL would be ineligible as offset providers.

Offset rules as proposed in the Task Group on Emissions Trading Report, would preclude existing offset projects from being eligible to generate credits under the ETS, since they commenced before 3 June 2007.

Further, such projects could not reapply for accreditation as an offset provider if the projects were within sectors covered under the ETS. In this instance, the market fails to reward early movers of low-emissions intensive generation and the offsetting of black power consumption. In doing so, the ETS effectively penalises projects of net environmental benefit.

Make-good provisions

EDL supports the implementation of make good provisions both to ensure the cap is maintained, and to assist in linkage with other schemes where such provisions are required.

Compensation

EDL supports compensation in the form of either cash or permits.

International linkage

In moving towards a global market, and in recognition of GHGs as a global issue, EDL supports the linkage of markets and of offset regimes at both a regional and international level.

In summary, if fugitive emissions from the coal and waste sectors are covered under the ETS, EDL may:

- Suffer permit liability;
- Lose income through the ending of GGAS;
- Be ineligible as an offset provider;
- Be ineligible to receive compensation; and
- Be locked into wholesale contracts at prices that do not value the above.

The consequence of such outcomes would be to have an ETS that is environmentally ineffective and economically inefficient in its support for low cost abatement.

Again, EDL thanks the Garnaut Climate Change Review for the opportunity to comment on the Discussion Paper.

Please do not hesitate to contact us should you wish to discuss any aspects of our comments.

Yours faithfully



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