

18th April 2008

Submission to ETS Trading Scheme discussion paper

Comments on Emissions Trading Scheme Discussion Paper

This paper provides my thoughts on the questions raised by the Emissions Trading Scheme Discussion paper, based on both my experience within the energy industry and a broader perspective gained through consultancy across many continents.

Climate change is has become a horribly fraught debate with the sceptics largely proposing an uncontrolled experiment on our children's future.

If we take preventive action by the introduction of an ETS and the sceptics are right, the downside is minimal, a cleaner environment and more energy efficient industry (which equates to more profits for shareholders). Should we adopt the sceptic's hypothesis and conduct the experiment of doing nothing, the consequences of finding their hypothesis is incorrect is almost too terrible to consider.

Given the probability of an unattractive climate outcome, it is essential that the ETS is designed in a transparent manner that motivates all participants to reduce energy and carbon intensity of their operations in line with an agreed trajectory.

Targets and trajectories

Adopting ambitious emissions budgets and trajectories is a sensible strategy for Australia to adopt:

- An ambitious emissions budget and trajectory will enable Australia to take a lead position in international negotiations, thus ensuring international agreements are favourable to our economy and political / social frameworks.
- We can protect companies that are exposed to international competition by competitors who do not pay carbon by refunding carbon costs on export.
- Recycling the permit revenue into making our society more energy efficient will increase our competitiveness irrespective of the climate change outcome
- In the unlikely event of global warming being proved wrong, an ambitious set of targets will have enhanced the energy efficiency of our economy, thus reducing the energy content of our products. This would be beneficial irrespective of the price of energy but should the "Peak Theory of Oil" be correct, a powerful competitive advantage.

Coverage of an ETS

- The absence of forestry is a serious oversight, given that it is reported that 20% of carbon emissions arise from deforestation. Inclusion of a carbon price on a per tonne of wood chip or wood products would encourage forestry operations to replant cleared land. This would have four major advantages:
 - Effectively making forestry a low carbon emission industry
 - Making forestry a sustainable industry as it replaces the natural resources that it is using
 - Creation of significant jobs from the replanting of forests; and
 - The establishment of a skill base that could be expanded into development of surplus forest replanting, which could be resold as offsets

Permit Allocation and transparency

- All participants in the ETS market should be required to purchase permits. Allocation of free permits will distort the early market, causing participants to lose confidence:
 - Holders of free permits will not act in the same manner as those who have had to purchase permits, thus creating distortions and uncertainty in an embryonic Australian carbon market.
 - The lack of transparency will undermine market pricing of carbon permits
 - Allocation of free permits will effectively be a transfer of wealth from the consumer to organisations with the strongest lobbying skills
 - Users of electricity will be seeking a once off transition and certainty about carbon pricing – provision of free permits will create significant uncertainty on future electricity prices. Investment in projects with high energy costs are likely to be delayed due to pricing uncertainty.

Compensation

- Industry should not be allocated any free permits, as the potential for carbon tax has been well known for a long time:
 - The green house issue has been established science for over 20-30 years. The Age Newspaper published a full page article on global warming on Friday 18th March, 1988, which has proven to be eerily accurate in its forecasts.
 - The first major Australian conference on climate change occurred in late 1987, entitled “Greenhouse ‘87”.
 - Since the late 90s, whenever privatisation of the NSW electricity assets are discussed in the newspapers, the issue of carbon tax indemnity is usually raised. One can only assume that the purchasers of privatised assets and developers of new generation assets in the National Electricity Market will have considered the likelihood of a future carbon pricing regime. A Google search indicates that both the ESAA and specific electricity companies have been very active on the issue of carbon pricing over this period. Hence, one should assume that a rational investor will have included the potential for carbon tax in their assumptions.
 - The European experience argues strongly against a free permit solution.
- Should a strong case be made for compensation, then such compensation should be made with the proceeds of the permit fees in a transparent (out of carbon market) manner. This provides transparency and ensures that the initial market in carbon is not distorted by an overhang of free permits.

Use of Permit revenue

- All permit revenue should be used to improve the energy efficiency of society as well as making the structural adjustments to declining communities and poorer households.
- As noted above, any compensation should be paid out the permits revenue.
- One mechanism that is worth considering is a reverse auction fund, whereby petitioners seeking government assistance would bid competitively on a carbon reduction per dollar of grants. Such a mechanism would ensure that grants would go to proposals that delivered the largest carbon reduction per dollar of grant rather than allowing the “selectors” to choose champions. Using the McKinsey global abatement cost curve as a guide, such an approach would see technologies to the left of the curve funded ahead of those on the right.
- Early and easy wins in reducing our carbon footprint can be achieved from making our residential and commercial property portfolios more energy efficient. Clearly funding to encourage consumers to adopt solar hot water, adequate roof insulation, double glazing and the move to more efficient

lighting needs to be prioritised as early energy efficiency measures. Promoting the adoption of solar power makes considerable sense when you consider the avoided investment in generation, transmission and distribution, as well as, the avoided energy losses across the energy value chain.

Offsets

- The promotion of *high quality* forestry offsets, along with methane destruction, should be encouraged as these are proven technologies that can make an early material impact on emissions. Many technological solutions have a long lead period or the underlying assets have a long replacement cycle (eg coal generation plants). There are some implementation issues in monitoring and measuring the claims from “offsets” but these are not insurmountable.
- Adoption of international offsets such as the PNG option, previously discussed by this review group, makes strong economic sense, provided that mechanisms ensure that we are seeing net new forest development.

Yours sincerely

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Hugh has over 12 years of experience in the energy industry. He has been employed by, and provided consulting services, to energy utilities across four continents and has been heavily involved in climate change issues for around 5 years. He is currently advising an ASX 50 company on climate / carbon related issues.