Submission Cover Sheet:

Clean Energy Legislative Package

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Date:	25th August, 2011

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Submission Instructions

Submissions should be made by **5pm on Monday, 22 August 2011**. The Department reserves the right not to consider late submissions.

Where possible, submissions should be sent electronically, preferably in Microsoft Word or other text based formats, to the email address – cleanenergybills@climatechange.gov.au

Submissions may alternatively be sent to the postal address below to arrive by the due date.

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Investor Group on Climate Change

25th August 2011

IGCC Submission: Exposure Draft of Clean Energy Future Bills

1. Introduction

The Investor Group on Climate Change (*IGCC*) welcomes the opportunity to submit its views on the Exposure Draft of the Clean Energy Future Bills (*Bills*).

IGCC represents Australian institutional investors (superannuation funds and investment managers), with funds under management of over $600 billion, and other key participants in the investment community. We are managers of retirement savings and investments, concerned with the long-term stability of the economy and the impacts of climate change. We invest in all sectors of the economy, emissions-intensive and low-emission alike, and are part owners of many Australian companies.

We interpret the emerging international framework under the Cancun Agreements as being one in which each nation must determine the most appropriate and cost effective policies to meet their own emission reduction targets. This may lead to differences in national policies based on national circumstances and does not mean that national action to reduce emissions should be delayed.

Additionally we believe that addressing the risks of climate change and making adjustments to emissions intensive industry are long term economic issues and policy action should not be delayed because of short term volatility in financial markets.

IGCC wishes to preface its comments on the Exposure Draft of the Bills with a re-statement of the reasons to avoid further delay in the introduction of a carbon price in Australia, including:

1. The Clean Energy Future framework meets key investor criteria for policy certainty and will allow important investment decisions to proceed;
2. Alternative policy frameworks that rely solely on direct government intervention are more costly and unlikely to provide certainty for investors;
3. Commencing carbon pricing without delay means lower relative costs to reduce emissions.

Regarding the Bills, IGCC considers the drafting to broadly reflect the policy statement of July 10th, 2011, but wishes to raise a number of matters to ensure that clarity is maintained and unintended consequences are avoided in the drafting of regulations. These matters are outlined in section 3 of this submission.

2. Background

2.1 The Clean Energy Future framework meets key investor criteria for policy certainty

IGCC considers that the 'Clean Energy Future' policy framework meets the key criteria for policy certainty sought by investors including:

- Transparency, longevity and predictability in the scheme design;
- Capacity to achieve targeted emissions abatement outcomes;
- Ability to ensure low costs for emissions abatement outcomes.

IGCC further considers that narrow interpretations of Australia's proposed carbon price, which transitions to an emissions trading scheme, as a simple 'tax' are not conducive to interpreting its likely cost and effect.

Of specific importance to investors regarding the design of the scheme are:

- *Transparency, longevity and certainty of the policy framework:* The Bills provide a carbon price framework with a clear, legislated transition from fixed to floating pricing; a 2050 reduction target in line with scientific recommendations; and, an independent Climate Change Authority to report on the trajectory to meet the 2050 target and provide transparent institutional arrangements going forward;

- *Likely emission abatement outcomes:* The purpose of an emissions trading scheme is to allow a national emission reduction target to be met, where the price varies in response to demand. Alternative policies, such as carbon taxes and direct action approaches do not prioritise or ensure the meeting of national targets and therefore provide little certainty over emission growth in the economy.

- *Cost of achieving emission abatement outcomes:* According to the Productivity Commission Report, *Emission Reduction Policies and Carbon Prices in Key Economies*, evidence suggests that explicit carbon pricing frameworks achieve relatively low cost emission abatement outcomes.[1] The overall cost of emission abatement outcomes for Australia will therefore be lower than if no carbon price were introduced.

IGCC's view is that the Clean Energy Future Bills provides a suitable carbon price framework with appropriate complementary policies and provides a transparent, effective and relatively low cost policy framework for Australia.

[1] *Emission Reduction Policies and Carbon Prices in Key Economies*, Productivity Commission, June 2011

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2.2 *Alternative policy frameworks that rely solely on direct government intervention are more costly and unlikely to provide certainty for investors.*

As indicated above, IGCC assesses the merits of policies to reduce emissions in terms of their: transparency, longevity and certainty to investors; whether they are likely to achieve targeted emission abatement outcomes; and the relative cost of the emission abatement outcomes achieved. We consider that direct action policies are unable to meet these criteria in isolation of carbon pricing.

Longevity and certainty

Investors consider direct government policies to be relatively costly and in isolation unviable for capping national emissions. As a consequence, any policy framework that relies solely on direct government measures is likely to be subject to change and unable to meet investors' preference for policy certainty and longevity.

Direct policies are constrained in a number of ways, including:

- capping total emissions may be more difficult as there is no incentive for companies to reduce emissions if they do not qualify for financial support to do so;
- there is no transparent investment signal in the market as decisions about emission reductions are subject to government priorities and budgetary constraints;
- when governments directly regulate or select and fund abatement opportunities, these are unlikely to be achieved at relatively low cost, given that there is no competitive pressure to avoid or reduce emissions in the market.

Given these material limitations, investors consider that direct policies are unlikely to be viable in isolation from carbon pricing as a long term policy response to reducing Australia's emissions.

Given that carbon pricing has been shown to be a low cost policy framework, IGCC assumes that even if a carbon price were not introduced in the short term, a future government would eventually need to introduce such a scheme in Australia. There is sufficient evidence of national and sub-national regions implementing or trialling carbon price frameworks to suggest that the benefits of market based mechanisms are understood by Governments even if the short term politics to implement them are problematic.

Assuming that a carbon price would eventually be introduced in Australia because of its benefits in terms of low cost abatement and certainty over emission reductions, direct action policies are better limited to complementing carbon pricing and efficiently addressing non-price barriers to reducing emissions.

2.3. *Commencing carbon pricing without delay means lower relative costs to reduce emissions*

IGCC believes it is important to restate our view that increased economic cost will be incurred through delaying the commencement of a carbon price in Australia.

Research conducted for the Investor Group on Climate Change and Catholic Super by economic modelling firm SKM / MMA has found that delaying the start of a carbon price in Australia would cost investors and electricity users more than under a 2012 start.[2]

The research, which focussed on costs of delay in electricity markets, showed that delaying the start of a carbon price in Australia by only four years from 2012 to 2016 would lock in additional costs of over $2.5bn in the period to 2030 and specifically:

- delay the switch from coal to gas for base load electricity;
- result in less efficient electricity plant build, locking in additional economic costs of around $500m to 2030 ($1bn to 2050) ;
- incur $2bn in additional emission costs for the economy to 2030 ($2.8bn to 2050);
- cause wholesale electricity price increases to reach 19% or $13/MWh more than necessary and average $6/MWh per annum higher in the period 2016 to 2030.

The main reasons for the additional economic cost are the building of inefficient electricity generation plant which may have slightly lower cost in the short term but lead to much higher cost in the long term, and the higher cost of replacing unprofitable, emissions intensive plant after 2016 including likely labour shortages that result.

The additional emission costs are incurred through permit purchases and are in lieu of even greater economic costs that would be incurred if emissions in the domestic electricity market were forced to reduce by 5%. Forcing the electricity market to achieve a 5% emission reduction would result in higher economic costs than the permit prices included in the results. The additional costs result from the fact that emissions would be 90 million tonnes higher under the delayed start scenario than they would be in the 2012 start scenario.

Starting a carbon price in 2012, with or without a fixed price period in the first few years, would fully avoid these increased costs to investors and electricity users.

These costs can be avoided regardless of the speed at which other countries formalise their carbon pricing arrangements.

A 5% emission reduction below 2000 levels by 2020 was assumed in this research. If Australia's 2020 emission reduction target became deeper than 5%, the economic cost of delay would be higher than the results of this research indicate.

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[2] *Impacts on electricity markets of delaying an emissions trading scheme*, SKM/MMA, June 2011

As this research modelled the cost of delay in the electricity market only, it does not include additional costs associated with delaying the start of carbon price, mainly from higher electricity prices, in other sectors of the economy. The research did not attempt to capture any costs associated with the physical impacts of climate change or competitiveness impacts for Australia from delayed transition to a lower carbon economy.

On the basis of this analysis, IGCC considers that rather than costing the economy more, introducing carbon pricing in 2012 will cost the economy relatively less if the 5% emission reduction target is to remain a minimum target for 2020.

3. Comments on the Clean Energy Future Bills

The following points are made to record our understanding of the implications of drafting in the Bill and highlight areas in which we encourage the Government to consult around the development of Regulations.

Section 111. Auctioning of permits

Our understanding that the wording of section 111 "*the amount the person indicated or declared that they would be willing to pay*", is not intended to imply that the auction process for permits will be designed as ‘pay as bid’ rather than ‘pay the clearing price’ as was the case in the CPRS.

We further note that the Government is expected to consult stakeholders on the auction process before it is resolved in regulation and that no dates for the first auction of permits, including any forward permits for the flexible price phase of the scheme has been set.

IGCC urges the Government to allow sufficient time for consultation on the auction process and as much notice as possible on the likely auction date for forward permits in the scheme.

Section 218/219. Significant holding provisions

IGCC notes the likely commercial sensitivity of information related to permit holdings cycling above and below a 5% holding threshold. We also note that this provision was not detailed in the policy announcement of July 10th, 2011.

In order to remove the likelihood that commercial information would enter the market in a time sensitive way, obligations to disclose the triggering of the 5% threshold may be delayed by a period of months. We note that in the United Kingdom, significant holding provisions allow for a six-month delay before disclosure of passing the 5% threshold is required.

Section 101. Auction of forward vintage year permits

We restate our view that consultation with stakeholders on permit auction processes is necessary before these are resolved in regulation.

Clean Energy Finance Corporation

IGCC considers there is significant potential to leverage private sector investment with public co-investment structures that: complement market based policies; address market failures and non-price barriers to investment; improve the risk / return equation for low-carbon investment relative to carbon intensive investment.

We notes that the investment mandate for the CEFC will be developed at arms length from Government by an independent chair. We encourage the Government and Chair elect to consult with the investment community on financing structures that will attract private capital to renewable energy and technology investment.

Section 100, Section 288. Setting the price floor and ceiling

We note that the price ceiling is established through the mechanism in s100 which provides for permits to be issued for a fixed charge during the first three years of the flexible price period and that the fixed charge will be established by regulation.

We further note that the draft legislation does not contemplate an extension of the three-year period of a price floor and ceiling and that this is consistent with Government and MPCCC statements on providing certainty in transition from fixed to flexible pricing.

We advise against making any changes to the Bill that would introduce uncertainty around the length of time that the price floor and ceiling would operate.

We note that the Climate Change Authority may make recommendations on future changes to the legislation regarding price floors, but that an amendment to the legislation would be required to effect the change.

Section 123. Surrender of international permits

We note that drafting in the Bill reflects the policy statement of July 10th. We caution that the effect of Government accepting certain classes of permits in the scheme, then later prohibiting them, may undermine the confidence of private investors in Government

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processes to endorse permits and may limit investment in various classes of international permit.

We accept that balancing the rights of private investors with the environmental integrity of the scheme is an important consideration for the Government.

As drafted, it is left to the provisions of the Regulation to clarify the point in time from which the international units will no longer be eligible emissions units for compliance purposes. We submit that our concerns would be mitigated to an extent by allowing liable parties to surrender 'prohibited' permits for the recent compliance year (and submit these by February the following calendar year (consistent with rules on submitting permits) but not subsequent years.

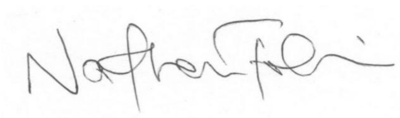
4. Concluding comments

If Australia is to reduce its emissions by at least 5% below 2000 levels by 2020, IGCC considers that there is greater economic risk and cost for investors and energy users associated with delaying the introduction of a carbon price in Australia, than with commencing in 2012. Commencing a carbon price and related policies in 2012 reduces risk that the target will be missed and / or that more stringent regulatory responses are needed to deliver the emission reduction outcome later. This also reduces risk for our investments.

The proposed carbon pricing framework compares favourably with those of trading partners and competitors on key criteria including the transparency, longevity and certainty in scheme design, the capacity to meet targeted emission reductions and the relative cost of achieving those emissions reductions.

IGCC has been actively involved in the policy discussion on carbon pricing in Australia since 2005 and we consider that it is now time to commence this critical policy for Australia.

Yours sincerely,



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