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Dear Sir

Liabilities for relevant entities under the Victorian Energy Efficiency Target (VEET)

The Australian Industry Group welcomes the chance to provide input on possible amendments to the VEET. Our members include both large and smaller energy users, and we are keen to see an early and equitable resolution to the liability issues under the VEET.

Ai Group recognises and supports the underlying intention of the VEET: to put downward pressure on energy bills at a time of high and rising energy prices by supporting more efficient use of energy. Like other stakeholders and the Government itself, we believed that all energy users, including large users, would be better off in net terms under the expanded scheme that commenced from 1 January 2012. To date, however, the scheme as implemented is not performing as expected. It is vital that the scheme be amended as soon as practical to ensure it lives up to expectations and intentions. In the attached submission Ai Group provides input on the most appropriate ways to amend the scheme.

To ensure that amendments are effective and without unintended consequences, Ai Group urges the Department and the Government to convene a meeting of key stakeholders, including energy users, retailers and certificate providers, shortly after the close of submissions. The meeting should provide an opportunity to both discuss the appropriate changes to make and to highlight and solve practical implementation problems.

Should you have any questions, please contact our Principal National Adviser – Public Policy, Tennant Reed, on (03) 9867 0145 or at tennant.reed@aigroup.asn.au.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Tim Piper', is written over a horizontal line.

Tim Piper
Director – Victoria

Liabilities for relevant entities under the Victorian Energy Efficiency Target – Australian Industry Group submission

The Australian Industry Group (Ai Group) strongly supports the early amendment of the Victorian Energy Efficiency Target (VEET) to avoid unintended net costs to large energy users who have limited or no opportunity for direct benefit from the scheme.

Change to liability

Adjusting the basis on which retailers' liability is calculated to remove supply to large energy users is the most appropriate way to shield large users from VEET costs, which as noted in the discussion paper were not originally anticipated to fall on large users. Ai Group recognises that of itself such a change will not prevent retailers from making their own decisions about how to distribute costs across their customer base. However, we are confident that a change of the sort proposed would put large users in a strong position to resist the inclusion of VEET-related costs in their price negotiations with retailers.

The proposed change would exclude only supply to sites covered by an Environment and Resource Efficiency Plan (EREP). Ai Group agrees that such sites should be effectively exempted from VEET costs. Nonetheless there is a problem with the proposed approach: there are large or intense energy-using sites that do not have an EREP.

Large energy users with non-EREP sites

We are advised by some member businesses with high energy use that as little as half of that energy use takes place on EREP sites. Consequently, they would see only partial relief under the proposed changes, and indeed the cost burden on the unexempted portion of their energy supply would likely grow (see discussion of targets below). This is especially problematic for trade-exposed businesses during a period of intense currency pressure and large non-VEET-related energy price rises. The problem is further compounded where those businesses are effectively unable to access direct scheme benefits because of the relatively slim list of currently approved activities.

EREP nonetheless remains a better proxy for large energy use than Emissions Intensive Trade Exposed (EITE) status; after consulting with our membership we believe that a purely EITE-based exemption would disadvantage some while failing to address the gaps in the EREP approach.

One solution is to focus on EREP businesses, and to extend the exemption to energy supplied to customers with an EREP site, rather than just energy supplied to EREP sites themselves. This is no more difficult for retailers to administer than the current proposal.

A second option which would also work well for large users would be to apply the exemption based not on EREP status but on a separate energy threshold: the large user definition applied in the ACIL Tasman modeling that underpinned the decision to expand the VEET. We understand that this threshold equates to around 43 terajoules of energy consumption at a site. Such a threshold would bring the expanded VEET much more closely into line with the modeled policy. This approach would require some additional information sharing between customers and retailers where a site may have electricity and gas supplied by two different retailers. Such issues should be easily overcome, but will need to be fully discussed between stakeholders and the Government.

If a solution along the lines of these options is not adopted, it will be even more crucial for a wider range of energy saving activities more relevant to larger energy users to be approved as soon as possible.

Date of effect

The paper proposes that the basis of retailer liability be amended with effect from 1 July 2012. The reason for this delay is to prevent the need to retrospectively amend the Greenhouse Gas Reduction Rates (GRRs) that applied from 1 January 2012. However, Ai Group strongly believes that the change to liabilities should apply to the whole of the 2012 compliance year. Large energy users have been paying significantly higher energy prices as a result of the unforeseen operation of the expanded VEET. They should not have had to pay those prices in the first place. A number of large users has been in active dispute with their energy retailers over VEET costs and has withheld payment of them pending the amendments currently under consideration; most have paid. Ai Group's view is that the best outcome would see all large users subject to EREP in a position to seek a refund of EREP charges from their retailers. This can be achieved by applying the proposed liability change to the whole of 2012.

The Department argues that such a change would require retrospective adjustments to the GRRs, which would entail legislative amendment – a more protracted process than a change to the regulations. However this is not necessarily true; there are at least two alternatives.

1. *Larger GRR adjustment from July 2012.* The 2012 VEET target is 5.4 million tonnes of CO₂-equivalent abatement. So far energy retailers have been accruing liabilities consistent with this target on sales to all their customers. The proposed change would narrow the sales base from July while raising the GRR to ensure the target is still met. However it would be just as possible to raise the GRR even further, enough to meet the target from a sales base narrowed for the whole of 2012. Smaller energy users would in effect pay in the second half of 2012 what they would have paid over the whole of 2012 if the system originally envisaged (and modeled) been applied. This is not Ai Group's preferred option, as it introduces further price shocks to energy users at a time of considerable pressure, but it would be preferable to the Department's proposal.
2. *No GRR adjustment in 2012.* A much better alternative would be to narrow the sales base for the whole of 2012 while maintaining the existing GRRs. This would in effect fully exempt large users from VEET-related costs while avoiding further impacts on smaller users in 2012. However, this option would obviously result in the 2012 VEET target not being met. As argued below, this should be an acceptable outcome to all parties.

Target and adjustment to Greenhouse Gas Reduction Rates

The 2012 target for the VEET is double the 2011 level. The modeling conducted for the Regulatory Impact Statement indicated that doubling the target would lead to attractive benefits for all energy users over time, both from direct savings to parties generating certificates and broader benefits in reduced wholesale electricity prices and avoided capital investment. Even though the modeling assumed that upfront scheme costs were not spread to large users, the net benefit to smaller users was still strong.

In practice, of course, the broader benefits of VEET-like schemes are enjoyed well after the initial costs, and the benefits are less transparent and easily recognized than costs. In these circumstances the tolerance of energy users for further cost increases is limited, even where the case can be made that longer-term benefits will result. There is a serious risk that an additional round of VEET-related energy price increases for smaller energy users in 2012 will elicit a strong negative reaction from the community, particularly given the other price pressures this year.

The Government opted for a doubling of the VEET target on the basis that this seemed to offer the greatest benefits. Ai Group considers that the target should not be viewed as an absolute imperative that must be met at all costs. Given other immediate price pressures on energy users the best course would be to in effect ramp up to the 5.4mt target more slowly by not adjusting the GRRs until 2013.

This approach would reduce (or, more likely, defer) some of the downward pressure on energy prices that adherence to the full 2012 target might be expected to provide. However, in the shorter term the suggested changes would have a negative impact on only one group: would-be certificate generators, particularly energy services companies (ESCOs), who may have geared up in anticipation of a particular level of demand in 2012. The expectations of such businesses, based on stated Government policy, legislation and regulations, deserve recognition. However, there are three reasons to view a shortfall on the 2012 target as acceptable even from this point of view.

1. The industry's market is currently set to double from the 2011 level in terms of certificate numbers, and potentially more than double in terms of revenue if prices reach modeled levels. Even something short of a doubling is an outcome most industries would envy.
2. The formal targets for 2012-14 would remain unchanged and new GRRs would be set for 2013 and 2014 to ensure the annual targets were met. The market would still reach its anticipated levels – just on a slightly longer timeframe.
3. Changes to the VEET along the lines currently proposed have been discussed by various stakeholders since January 2012. The relatively low prices this year for Victorian Energy Efficiency Certificates (VEECs) may already price in the possibility of a policy response that reduces 2012 demand below 5.4 mt.

Thus the changes Ai Group proposes should allow for a more measured transition to the fully expanded VEET that would avert additional costs for large users ineligible to participate, avoid causing further 2012 price increases for smaller users, achieve a high proportion of originally expected benefits and provide ESCOs with a market that is still substantially larger than in 2011.

Definition of Relevant Entities

The current exemption of energy retailers with fewer than 5,000 customers from VEET liability does seem to risk distorting competition in the sector. However, Ai Group is aware of large energy using businesses who are currently unaffected by VEET because their retailer falls within the 5,000 customer exemption. A change to the definition of relevant entities would only be acceptable to such businesses if it is preceded by the other proposed changes to the base of liable energy supply. Once large energy user issues are satisfactorily addressed, a carefully drawn amendment to the definition of relevant entities would be appropriate.