



18 August 2008

Mark Wakeham
Campaigns Director
Environment Victoria
Level 2, 60 Leicester Street
CARLTON VICTORIA 3053

Dear Mark,

HRL Ltd – Proposed Brown Coal-Fired Power Station and the Carbon Pollution Reduction Scheme Green Paper

You have requested advice on HRL Ltd's ("HRL") proposal to construct and operate a brown coal-fired power station ("the power station"), and the likely impacts of the Commonwealth Government ("the Government") proposed Carbon Pollution Reduction Scheme ("CPRS") on this.

The Government's intention for a Carbon Pollution Reduction Scheme is outlined in the "Carbon Pollution Reduction Scheme Green Paper", July 2008 ("the Green Paper").

The Green Paper does not have any legal effect in the sense of creating rights and obligations. It is, however, intended to provide clarity and guidance as to the manner in which the Australian Government's commitment to introduce an emissions trading scheme in Australia will be fulfilled. Although there will undoubtedly be some refinement of the proposed CPRS before it becomes legislation, the general framework and central principles are now clear. This legal advice is based on the legislative framework foreshadowed by the Green Paper.

You have asked for our advice on the following:

1. Is the power station proposed by HRL subject to the CPRS?
2. Is a coal-fired power station a "Strongly Affected Industry" under the CPRS?
3. Will the HRL proposal qualify for compensation as a "Strongly Affected Industry" under the CPRS?
4. Could HRL argue that they are an "Emissions Intensive Trade Exposed Industry", and qualify for compensation under the CPRS in this manner?
5. What other approvals do HRL require before commencing what is proposed?

Detailed answers to these questions are provided below. By way of summary, our conclusion is that any new coal fired power station, including that proposed by HRL, will be the subject of the CPRS. We also conclude that no compensation or special treatment will be available to HRL on the basis that they are a "Strongly Affected Industry" or on any other basis.

The advice does not address whether the proposed power should proceed in these circumstances although the answers to the questions you have asked are clearly relevant to the viability of the proposal. In terms of process, we have noted that any proposal to proceed with the Power Plant will trigger the need for a range of approvals under Victorian and Commonwealth legislation. It is also likely that an Environment Effects Statement would be required.

Will the ETS cover the proposed activities of HRL?

The CPRS has been designed to cover a high proportion of national emissions with a relatively small number of liable parties. Exactly which firms will be impacted upon will depend on what level of emissions the 'cap' is set at, which is yet to be decided by the Government. The CPRS is estimated to place obligations on around 1000 liable firms, the highest carbon emitting firms in Australia. This is based on a baseline for inclusion of 25,000 tonnes of carbon emissions per year, although final coverage decisions are yet to be made by the Government. As operators of a 400 mega watt coal-fired power station, with anticipated CO2 emissions greater than 2.5 million tonnes per year, HRL will be covered by the CPRS in relation to these activities.

Are coal-fired power stations a "Strongly Affected Industry" under the CPRS?

The CPRS Green Paper identifies industries that are likely to be strongly affected by the introduction of carbon constraints and includes measures to assist these industries.

The CPRS Green Paper specifically identifies the coal-fired electricity generation industry as one that exhibits the characteristics of a "strongly affected industry" for a range of reasons. The arguments advanced as to why this special treatment should be available to coal-fired electricity generators include that coal-fired electricity generally employs significant long-lived assets with limited alternative economic uses and that the industry has had limited opportunities to adapt to the CPRS. It is important to note that these issues relate to impacts on existing generators, not proposed new generators.

There has been significant criticism of the Government's Green Paper position which proposes to compensate coal-fired electricity generators and that the Green Paper position runs counter to the preferred position of the Garnaut Review as outlined in its draft report. Therefore the final decision on compensation for coal-fired generators may differ from that proposed in the Green Paper. However the differences in this regard are likely to be in the form of less favourable treatment for coal-fired electricity generators and so will not alter our conclusions about the HRL proposal.

If the recommendations in the Garnaut Review are rejected, it is clear from the Green paper that the coal-fired electricity generation industry will be considered to be a strongly affected industry for the purposes of the CPRS, and that the Government thus considers it appropriate to implement measures that can assist the transition of this sector to the CPRS, which will include direct assistance (compensation). This will be done predominantly through a fund called the Electricity Sector Adjustment Scheme ("ESAS").

Will the HRL Ltd proposal for a new power station qualify for compensation under the "Strongly Affected Industry" provisions in the CPRS?

As noted above, the rationale for providing special treatment to coal-fired electricity generators is based on the circumstances of existing generators. As is explained in more detail below, it is unlikely that proposals for new plants will be subject to the same special treatment. More specifically, in our view the HRL proposal will not meet the eligibility criteria for compensation as a Strongly Affected Industry even on the most generous assumption as to the cut off date for the application of these provisions.

As explained in the Green Paper, the risk of an imposition of carbon constraints on emitting entities in Australia has evolved over time, rather than suddenly materialising. For the purpose of determining eligibility criteria for direct assistance, the Government has nominated a date by which the likelihood of a scheme of carbon constraint being introduced would have been widely known by industry. The date chosen by the Government for this is 3 June 2007 (the "eligibility cut-off date"), "the point beyond which investors could not reasonably argue that they had no knowledge of a potential carbon constraint"¹.

Only assets that were either "in existence" or a "committed project" on this date will be eligible for direct assistance under the CPRS. When determining whether a project is a "committed project", the CPRS has adopted the National Electricity Market Management Company ("NEMMCO") criteria as set out in the National Electricity Rules ("NER") (see attached).

The table below indicates the criteria for determining if a project had been fully committed by the project proponent, and whether or not HRL has fulfilled this criteria for the proposed power station.

NER criteria	HRL
Does the proponent have the right to the land for construction of the project?	You have instructed us that as at 3 June 2007 HRL had not acquired land for construction of the project. We understand that HRL is yet to acquire land for the project as at 18 August 2008.
Have contracts for the supply and construction of the project's major plant or equipment been executed?	You have instructed as that as at 3 June 2007 HRL had not finalised contracts for the supply and construction of the project's major plant or equipment. While HRL appears to have some contracts or MoU's in place with a preferred partner we have seen no evidence that HRL has executed contracts for the construction of the plant as at 18 August 2008.
What is the status of any relevant planning and construction approvals and licences necessary for the commencement of construction of the project?	HRL has not gained all of the relevant planning approvals for the project as at 3 June 2007. As at 18 August 2008 HRL is yet to receive relevant construction approvals and licences.
What is the level of commitment to financing arrangements for the project?	You have instructed us that as far as you are aware, as at 3 June 2007 HRL had not secured

¹ Green paper, p 375-376.

	financing or signed contracts for the project. Since 3 June 2007 HRL has signed a contract with the Victorian Government for receipt of a \$50 million grant towards the project. However as at 18 August 2008 there is no evidence that HRL has secured all necessary finance for the project.
Has project construction commenced, and/or has a firm date been set for it to commence?	No.

As can be seen from the above analysis, HRL will not qualify as a “Strongly Affected Industry” under the CPRS as the proposal is clearly not a “committed project” and therefore can not be said to have been “in existence” on 3 June 2007 cut off date.

Furthermore, even if a more generous cut off date is adopted (for example the date of publication of the Green Paper), the HRL proposal could still not be said to be a “committed project”, according to the NER criteria as they have not at the time of preparing this advice satisfied the required criteria and are unlikely to do so for some time.

Could HRL argue that they are an “Emissions Intensive Trade Exposed Industry”, and qualify for compensation in this manner?

Under the CPRS, assistance in the form of free permits will also be provided to the most heavily emissions-intensive trade-exposed activities. Trade-exposed industries are those which can not pass on their costs to the consumer as they face prices set in international markets, and compete against firms that do not at this stage have comparable carbon constraints. The assumption is that if constraints on emissions are placed on activities in Australia but not elsewhere, there is a possibility that some emissions-intensive trade-exposed activities (EITEs) may choose to leave Australia. This will result in what is known as “carbon leakage” (EITEs choosing to relocate elsewhere, with no consequent global reduction in emissions).

The CPRS does not provide a test for assessing what is or what is not a trade exposed industry. Instead, it specifically identifies industries that are *not* trade exposed, and considers all others for EITE assistance. Those industries that are not trade exposed are those that produce goods specifically for the domestic market and for which there are physical barriers to trade. Those in this category specifically identified in the CPRS Green Paper include: electricity supply; natural gas and gas supply; and domestic transportation.

The HRL coal station proposes to burn brown coal in a process known as Integrated Drying Gasification Combined Cycle (IDGCC), which is asserted to be “cleaner” than black coal. There have been claims by HRL that they will seek exemptions from the CPRS claiming they are trade exposed on the grounds that they intend to export IDGCC technology to China.

The provisions in the Green Paper for determining whether or not an industry is trade exposed does not extend to the situation presented by HRL. Coal-fired power stations are

by their nature not trade exposed, and it is difficult to see how the HRL proposal could be argued to have unique elements that causes it to face prices set in international markets.

If the IDGCC technology reaches export stage, HRL should have to prove trade exposure in relation to that particular product (for example, if they are competing with overseas firms offering the same technology that are not subject to carbon constraints) in order to qualify for EITE compensation. It is very important to understand that that any exemption from the CPRS would be limited to business comprised of the export of technology rather than the operation of the proposed plant in Victoria.

What other approvals do HRL require before commencing what is proposed?

It is probable that an Environmental Effects Statement (“EES”) process will be required to assess the environmental effects of what is proposed by HRL.

To determine whether an EES is required, consideration of the Ministerial Guidelines for Assessment of Environmental Effects under the Environmental Effects Act 1978 (“the Ministerial Guidelines”) must be given.

The Ministerial Guidelines specifically provides that the “potential greenhouse gas emissions exceeding 200,000 tonnes of CO₂ equivalent per annum, directly attribute to the operation of the facility” as a situation that requires the referral of a proposal to the Minister for Planning for a determination as to whether an EES is required.

The following examples are outlined in the Ministerial Guidelines as to when an EES is ‘typically’ required:

- “When there is a likelihood of regionally or State significant adverse effects on the environment.
- When there is a need for integrated assessment of potential environmental effects of a project and the relevant alternatives
- When normal statutory processes would not provide a sufficiently comprehensive, integrated and transparent assessment.”

The HRL brown-coal fired power station is anticipated to directly emit 2.4-2.7 million tonnes of CO₂ per year. This amount is over 10 times the referral criterion of 200,000 tonnes of CO₂ emissions per year, and provides a strong basis for an argument that there are adverse environmental effects of regional and State significance, for which an EES is required.

It is our opinion that a decision by the Minister to not require an EES would seriously undermine the credibility of the Ministerial guidelines.

In conclusion, the HRL proposal will be subject to the CPRS foreshadowed in the Green Paper. It is unlikely that HRL will qualify for any sort of direct assistance from the Government or exemption as either a Strongly Affected Industry or an Emissions Intensive Trade Exposed Industry. The Green Paper’s dealings with EITE Industries clearly indicate that the electricity generation industry does not qualify as trade exposed.

Please contact us if you require any further advice on this issue.

Yours faithfully

A handwritten signature in black ink, appearing to read 'B Sydes', with a long horizontal flourish extending to the right.

Brendan Sydes

Principal Solicitor