

Qenos Pty Ltd

Submission to the Renewable Energy Target Review Issues Paper

Introduction

Qenos welcomes the opportunity to provide comment to the Climate Change Authority review under the Renewable Energy (Electricity) Act 2000 of the operations of the Renewable Energy Target (RET).

Company Background

Qenos (and its antecedent companies) has been an integral part of Australia's plastics industry since the establishment of the Alkathene Low Density Polyethylene Plant in Botany, NSW over 50 years ago. Since that time, Qenos has grown to become Australia's largest producer of plastics and petrochemicals and the sole manufacturer of polyethylene. Our Australian operations employ 730 staff at two plants, including 280 employees at Botany, NSW and 450 employees at Altona, Victoria. These facilities have a significant impact in the regional communities surrounding the plants.

Qenos is a key player in a number of manufacturing and related supply chains. For many of our customers, Qenos is the main supplier by value for plastic and chemical products. Our company supplies polymer to hundreds of small to medium businesses in addition to its major corporate customers.

The plastics and chemicals industry is a value-add sector which transforms Australia's natural resources into quality manufacturing products. Over our 50 years of manufacturing in Australia, we have secured long-term supplies of ethane and liquid petroleum gas feedstocks that are delivered through well established infrastructure.

Ownership Arrangements

Qenos is a subsidiary of China National Bluestar (Group) Co Ltd (China Bluestar), which is a joint venture between China National Chemical Corporation (ChemChina) and The Blackstone Group.

ChemChina is a large-scale state owned enterprise, a global Fortune 500 company established by the State Council of the People's Republic of China, and is one of the leading specialty chemical and petrochemical companies in China with headquarters in Beijing. China Bluestar, also based in Beijing, is a specialised subsidiary of ChemChina and focuses on chemical products and new materials.

The Blackstone Group is a leading global asset manager and provider of financial advisory services listed on the New York Stock Exchange.

Qenos and the RET

Qenos's operations are significantly impacted by the RET as follows:

- Qenos is a major electricity consumer, with a demand of approximately 350,000 MWhrs per annum distributed relatively evenly between the Altona and Botany operations. Therefore the introduction of the RET has had a material impact on the costs of running our operations.
- Qenos's operations include three EITE activities:
 - Production of Ethene (Ethylene) – Highly Emissions Intensive;
 - Production of Polyethylene – Moderately Emissions Intensive; and
 - Production of Polymer Grade Propylene – Highly Emissions Intensive.
 Qenos receives Partial Exemption Certificates for these activities.
- Qenos is in the process of installing a Cogeneration Facility at its Altona Operations. The Cogeneration Facility will produce most of Qenos's demand for electricity. This will result in Qenos:
 - becoming a liable entity for that part of the electricity produced that is not exempt; and
 - being exempt from the RET in relation to electricity consumed by Qenos within 1 km of the Cogeneration Facility.

Consequently Qenos's submission is focussed on the Exemption Section (Section 5.3) of the Discussion Paper and related issues.

Qenos is a member of Ai Group and the Australian Industry Greenhouse Network and has reviewed their submissions and agrees and endorses the recommendations set out in these submissions.

EITE Exemption

Qenos competes with imported polyethylene, which is primarily sourced from South East Asia and the Middle East. Consequently Qenos cannot pass through the costs associated with the RET to Qenos's customers. Qenos, like most manufacturers, has to deal with the pressures associated with the high Australian Dollar and increasing energy prices. Until recently, cheap energy was a competitive advantage for Australian manufacturers. With the significant and ongoing increases to energy prices in Australia, Qenos is less able to viably absorb additional costs. Therefore the EITE exemption is important to help maintain Qenos's competitiveness in the global markets in which it operates.

Qenos has invested significant expenditure in improving its own energy efficiency through the construction of a Cogeneration Facility. Therefore Qenos does not believe it would be equitable for Qenos to be exposed to the costs associated with the financial incentives provided to alternative forms of energy efficiency through the RET.

It is therefore important that the compensation offered through the application of Partial Exemption Certificates (PEC) be retained. Without the operation of PECs Qenos would have been exposed to an additional \$3.4M in costs since the introduction of the expanded RET. This is likely to increase in the next three years, with the likely increase in REC prices and an increased percentage as we approach 2020.

Qenos also supports the extension of the EITE assistance via PECs to cover all of the RET, including the original target of 9.5 TWhrs. Qenos agrees that the financial pressures affecting trade exposed businesses are far greater now than it was in 2001 when the original RET was introduced.

Self-Generator Exemption

Once Qenos's Cogeneration Facility is operational, Qenos will not be liable under the RET for certain electricity supplied from that Facility. Through the operation of the self-generator exemption in Section 31(2)(b) of the Act, any electricity that Qenos consumes within 1 km of the Cogeneration Facility will be exempt from any liability associated with the RET. Unfortunately for Qenos, about one third of the electricity generated from the Cogeneration Facility will be consumed by Qenos outside this 1 km zone. This is despite the fact that the electricity is being consumed at the same facility as electricity that is exempt under the self-generator exemption.

We understand that the self-generator exemption was introduced to address a specific policy concern, quite different from that justifying the EITE exemption. The EITE exemption is designed to insulate trade exposed businesses from the additional burden of costs being passed through by electricity retailers. The self-generator exemption is designed so as not to prejudice one form of efficient energy production against another. The relevant COAG discussion paper, which was released on 9 October 2009, stated that:

“[the exemption] could be considered as supporting the development of self-generation, for which a substantial proportion uses more efficient cogeneration technologies and less greenhouse-intensive natural gas or renewables”.

The Qenos Cogeneration Project is evidence of the rationale for this policy. Without the self-generator exemption, Qenos would have to acquire RECs (both LGCs and STCs) in relation to all of the electricity that Qenos will produce for its own consumption. The additional liability is likely to have been material enough for Qenos to decide not to proceed with the Cogeneration Facility. Even the exclusion of a third of the electricity has had a significant impact on the value of the project. To change the policy now would undermine the economics on which Qenos relied to justify its significant investment in constructing a Cogeneration plant.

It would be a perverse outcome if Qenos's Cogeneration project was not economically viable because of the RET liability. The Cogeneration Facility will reduce emissions associated with the production of Polyethylene in Altona by 100,000 tonnes and significantly improve energy efficiency when compared to the average efficiency of the National Energy Market. .

Qenos submits that the self-generator exemption should be amended so that all self-generated electricity, which is consumed by the owner of that generation, falls under the application of section 31(2)(b) of the Act.

The nature of the second limb of the exemption at Section 31(2)(b)(ii) effectively means that all electricity needs to be consumed within 1 km of the relevant facility. The second limb, relating to distribution on a dedicated line, is almost impossible to meet if the relevant facility is connected to a grid with a capacity of over 100 MW. If electricity is ever conducted down the relevant line, it no longer meets the requirements of the second limb of the exemption.

Qenos is investing in a new cable from its substation so that self-generated electricity can be supplied to a plant that is just over 1 km away. However, under the literal interpretation of section 31(2)(b)(ii), Qenos does not qualify for the exemption in relation to electricity conducted along this cable. This is because that line may be used to transfer grid electricity from time to time. Based on the forecast operating rates, Qenos expects the line will be conducting self-generated electricity for 95% of its operation.

This leaves just the exemption relating to the consumption of electricity within 1 km of the relevant power generator. This restriction is arbitrary and does not reflect the intent to exempt self-generated electricity. If Qenos had located the Cogeneration Plant elsewhere on its site, all electricity would have been consumed within 1 km of where it was produced, but the plant was located as close as possible to necessary utilities.

Qenos submits that the self-generator exemption could be broadened to ensure that all embedded electricity generated and consumed by the same entity or group is not a relevant acquisition for the purposes of the Act.

Liabe Entities

The Discussion Paper asks whether there are any other issues relating to the liability or surrender framework. The existing framework mainly imposes liability on electricity retailers. In most instances this is the most practical solution. The RET would be very difficult to administer if end users were liable entities.

A company with a large RET liability, such as Qenos, may look to manage its own liability by sourcing RECs from the market and supplying these to its retailer. This often enables an end user to reduce the costs of the RET because the end user is able to more effectively manage the risk and carrying costs of acquiring the RECs. However, in order for a company to manage its own liability it needs to reach a commercial agreement with its retailer. Some retailers are reluctant to offer this facility due to the risks associated with the failure of an end user to supply the permits in time for the retailer to meet its direct liability. Even if the financial risk can be managed through contractual compensation, the reputational risk of the retailer cannot be mitigated.

To address these concerns, consideration should be given to enabling an end user to assume the primary liability for the surrender of RECs from its retailer. This could operate in the same way as Obligation Transfer Numbers operate under the Clean Energy Act.

PEC Valuation

The proposed mechanism referred to above would also address another concern Qenos has with the existing system, the ability to obtain full value for a Partial Exemption Certificate (PEC). Under the current design, PECs are only worth what a liable entity values them for. Electricity retailers (representing the majority of liable entities) are able to recover the full costs of their REC liability from customers, irrespective of whether the customer is able to supply a PEC. Although Qenos believes it has generally received fair value for its PECs, in theory, a PEC may have no value to a retailer. A more vivid example would be where a retailer has invested in Renewable Energy to such an extent that it has a surplus of RECs and therefore needs to dispose of RECs on the spot market. In such an example the PEC may have negative value as the cost of

generating RECs may be greater than the price the retailer is able to recover on the spot market for any surplus.

If an end user was able to manage its own liability then it would be able to directly benefit from and therefore be more able to recover the full value of the PEC.

An alternative mechanism for addressing this concern would be to allow PECs to be traded in the same way that RECs are traded. PECs would then have effectively the same value as the spot price for RECs.

Timing

There are a number of changes to the time frames of the scheme that, if charged, would make the scheme simpler to manage and more transparent:

- LRET and SRES liability is not finalised until 31 March each year. This makes it more difficult for a company to accurately determine its likely RET costs and introduces greater risk for liable entities. This higher risk generally results in higher costs, via the imposition of risk premiums of RET liability. This risk could be reduced, and companies would be able to better manage their RET obligations if the relevant percentages were able to be declared at or before the beginning of each calendar year.
- SRES liability is surrendered quarterly rather than annually. This adds to the administrative costs associated with the SRES. The mechanism also means that the SRES liability has to be determined based on the previous years' consumption, which can cause issues of alignment if electricity consumption varies materially from year to year. Qenos would prefer it if the surrender of STCs was aligned with the surrender of LGCs, i.e. once a year on 14 February.
- Entitlements to PECs are calculated and issued near the end of each relevant period, making it more difficult to accurately calculate and manage the number of RECs required to meet a company's liability. It would be preferable to have PEC entitlements determined at the same time as any JCP entitlement. This may also save the costs of compliance with the production data being able to be assured at the same time.