



The Victorian Treasury and the Smelter Reduction Amount (C)

By October 2003, Sandra Denis and the Department of Treasury and Finance (DTF) working group were deeply immersed in devising a replacement for the Smelter Reduction Amount (SRA). (They were also working on a smooth transition as Adrian Nye prepared to leave the Department at the end of the year.) Despite the inherent difficulty in getting outside advice on such confidential matters, the DTF team was making progress. Said Denis: “We had a meeting with all the experts, came up with a whole suite of options, and did some very rough and ready analysis against each of those. We then culled it down to about eight which were more realistic and deserving of more detailed analysis.” But she harboured some doubt about whether the team could find an option that satisfied all the criteria at once. “We had identified a large number of ideas early on which suggested a solution could be found,” Denis recalled, “but as these options were investigated further and obstacles to their effectiveness identified, I must admit I was starting to worry that we could meet the Treasurer’s request for a clean and simple solution. What we were potentially coming up with was a ‘cocktail’ response, and that made me uncomfortable.”

This, as group member Ian Gibson recollected, meant that they would have to piece together a number of different options depending on the revenue-raising potential of each proposal. The DTF was also still open to broader revenue-raising options unrelated to the electricity industry. But costing each option took considerable work and the DTF was still not certain exactly how much money each proposal would generate. Nonetheless, from its initial alternatives, the team had whittled the list down

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further to seven possibilities by November 2003 which were presented to the Solicitor-General's office for assessment. From there, five shortlisted options were further assessed by the DTF and counsel, with the DTF to submit its preferred course of action to the Solicitor-General's office for final clearance in March 2004. This would give the new scheme time to be passed into legislation and implemented by the next financial year.

The five most viable options identified were as follows:

1. a stamp duty on hedging contracts
2. SECV concessional Transmission Use of System (TUOS) arrangements;
3. a levy on greenhouse gas emissions at the point of generation;
4. extending the current land tax scheme to include electricity transmission easements
5. an access charge for use of Crown land for transmission purposes.

Option 1: Stamp duty on hedge contracts

This option essentially involved placing a duty on hedge contracts entered into between electricity retailers and generators. This would involve amendments to the *Duties Act 2000* (Vic) which would apply to any hedge contracts entered into which used the Victorian spot price (i.e. the electricity trading price for Victoria set by the market management company NEMMCO) as the reference point for the contract. As retailers were most often (though not always) the buyers of electricity on the wholesale market, they would be primarily responsible for paying the duty.

Because the spot price between regions often differed, a retailer purchasing from the wholesale market to supply customers in Victoria would typically enter into hedge contracts which nominated the Victorian spot price as the reference price.

Approximately 60 percent of all hedging contracts were initiated in Victoria and the DTF knew that retailers, on average, would hedge at least 80 percent of their expected electricity demand. The length of hedge contracts could range from a day or a week, to 12 months or more. Based on forecast demand for 2004, the DTF calculated that the stamp duty would have to be set at a rate of \$3.00 per megawatt hour in order to raise the same amount of revenue as the SRA. The DTF was aware that there was still a considerable amount of work to be done in order to assess the likely impact of this option. Points raised were:

- Compared to other schemes which would break payments into instalments, this option required a fixed payment upfront which could amount to a great deal of money with respect to long-term contracts. There was concern that this could cause cash-flow problems for some retailers.
- Although it was not common, some hedging contracts did not specify set volumes of electricity, making the calculation of stamp duty difficult.
- Retailers could seek to avoid the stamp duty by hedging the cost of electricity against the reference price of another region. However, this would not protect them from price fluctuations when purchasing from the Victorian spot market.

- The stamp duty had the potential to significantly alter retailer and generator behaviour by, for example, encouraging retailers to reduce the number and length of their hedge contracts and increase their exposure to price fluctuations.
- Before introducing another stamp duty, the Government would need to consider its obligations under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, which sought to remove a number of stamp duties. This undertaking wouldn't necessarily apply to hedge contracts, but it was a matter for further investigation.
- While the stamp duty was unlikely to give rise to a challenge on the basis of its constitutionality, the proposed method of calculating the duty would still require careful legal scrutiny.

Option 2: SECV transmission concession

As the former SECV (now VicPower Trading) was subject to the same high-voltage network costs as other electricity distributors, there was the potential for VenCorp (the administrator of the network) to exempt VicPower from Transmission Use of System (TUOS) fees and charge the other users extra to recover the shortfall. The savings would then be put towards the losses incurred by the smelter agreements.

VenCorp had the authority to do this under the National Electricity Code (NEC) however under the Code any discount was also subject to scrutiny by the Australian Competition and Consumer Commission (ACCC) who could reverse VenCorp's decision. A "safe harbour" guideline meant that there was the potential for VenCorp to recover 70 percent of any discount from other customers providing that it absorbed 30 percent of the discount itself. However, there was still some uncertainty as to how these provisions would apply. On the basis that VenCorp could use the "safe harbour" clause, the DTF calculated that a net saving of \$6 million per annum could be passed on to VicPower Trading.

A related option the DTF was also pondering was making amendments to the NEC which would allow all of VicPower's transmission charges to be reallocated amongst the state's electricity distributors. This would also necessitate ACCC approval as VenCorp's revenue was capped by the ACCC until 2008, so any increase in charges to network participants would require ACCC sign-off. Nonetheless, the DTF thought it possible on the basis that the economic impact on industry (and ultimately consumers) would be no different than under the Smelter Reduction Amount (SRA). But this proposal also raised constitutional issues. Would the courts consider having VicPower's transmission costs paid by industry to be substantially different from imposing a levy on the wholesale price of electricity? Further legal clarification was required.

Option 3: Greenhouse gas levy

During their deliberations, the DTF explored a range of new taxes or charges that could be imposed on retail customers of electricity. The appeal, as outlined in the Options Paper, was simple: "A new levy imposed at the retail level is likely to be the most straightforward in terms of implementation and regulatory issues and has the capacity to match most closely the current incidence of the SRA." However, there was

the concomitant risk that the High Court could extend the meaning of excise under Section 90 of the Constitution to cover taxes on the consumption of goods.

One possible solution the working group considered was a levy on greenhouse gas emissions. Under section 23A of the *Electricity Industry Act 2000*, electricity retailers were obliged to include information in each customer's bill regarding the amount of greenhouse gases produced as a by-product of their electricity usage. The DTF proposed a levy based on the amount of "disclosable emissions" produced. Disclosable emissions were defined as the number of tonnes of greenhouse gas emissions calculated by applying the following formula:

$$(\text{MWh of electricity} - \text{MWh of "green power"}) \times \text{coefficient}$$

The coefficient would be calculated by the Sustainable Energy Authority, Victoria (SEAV), so as to reflect average greenhouse gas intensity of electricity sold in Victoria. "Green power" referred to energy supplied by retailers from renewable resources according to guidelines under the national Green Power Accreditation Program conducted by SEAV and other authorities. From a constitutional perspective, the DTF considered it safer than a straight-out tax upon consumption. This was because the levy could be seen as a tax on the production of greenhouse gases rather than electricity. Greenhouse gases would not likely be considered "goods", under the Constitution, therefore the levy would be legally sound. In addition, the fact that consumers would be able to reduce their exposure to the levy through the purchase of "Green Power" would, in the DTF's opinion, "further insulate the levy from constitutional challenge".

However, as the levy would vary with usage, there was still the possibility that it could be seen as a tax upon the consumption of electricity. At this stage, the legal robustness of this position was not entirely clear, nor was the amount of revenue likely to be raised. A greenhouse gas levy also had the potential to be applied outside the electricity industry. Though it could result in environmental benefits, the DTF was cognisant of the argument that, from a policy perspective, an emission tax should be designed to change behaviour, not raise revenue. Also, there were steps being taken in other forums to pursue a national emissions trading scheme and this approach could compromise those efforts.

Option 4: Land tax on electricity easements

SPI PowerNet owned approximately 6,500 kilometres of high-voltage electricity transmission lines in Victoria. Other high-voltage network providers included Murraylink - a 180 km transmission system running underground between Victoria and South Australia, with approximately 145kms running through Victoria. In 2005, there would also be Basslink - a 305 km electricity cable running from Loy Yang in Gippsland, Victoria across Bass Strait to Bell Bay in northern Tasmania, with 295 kilometres of the line running under sea. SPI PowerNet's transmission lines crossed large tracts of private land over which SPI PowerNet held easements. These easements also crossed significant parcels of Crown and public land. Option 4 proposed changes to the *Land Tax Act 1958* (LTA) which would make SPI PowerNet pay land tax on their transmission easements. Those changes could possibly be extended to easements owned by Murraylink and Basslink as well. This charge would

be passed on to the distribution companies and ultimately through to the consumer in much the same way as the SRA.

As outlined in the LTA, land taxes were normally levied on the “unimproved value” of all land, with some exceptions including a person’s principal residence and was payable by the “owner” of the land. “Unimproved value” referred to the value of the land alone, while the “owner” of the land was generally considered the owner of a freehold estate. However, certain other persons could be deemed to be the “owner” in certain circumstances (such as the holder of a leasehold estate in land under lease from the Crown). Changes to the LTA would extend the definition of “owner” to the holder of an easement used for the purposes of electricity transmission. However, determining the value of the easements would be an administratively complex procedure. As such, the DTF was not yet able to determine how much the scheme was likely to raise. Consequently, advice was sought from the Valuer-General to determine the approximate value of SPI’s easements – since SPI had the largest number of transmission easements in the state. With regard to calculating the value of the easements, the time available meant that specific site valuations were not possible and therefore estimation techniques were adopted.

This option didn’t create the same constitutional qualms as a greenhouse gas levy, but it did impact the electricity supply chain at an earlier point and therefore required certain approvals from the ACCC to ensure the cost of the land tax could be passed through to end use customers.

Option 5: Access charges to Crown land

This proposal was essentially a variation on Option 4 but instead would charge SPI PowerNet for access to transmission assets held on Crown land. As highlighted in the Options Paper, the *Electricity Industry Act 2000* gave SPI PowerNet and other electricity corporations various rights and powers in respect to their activities which were designed to ensure they had free access to the high voltage transmission network and could take any necessary actions to ensure the network’s safety and efficacy, including repairs, maintenance and the removal of obstructions.

But as the Option Paper also pointed out, SPI PowerNet (as of July 2002) had no licence arrangements in place in respect of transmission assets crossing Crown and public land. Indeed, SPI PowerNet was currently in the process of negotiating an agreement with Minister for Environment and Conservation with respect to SPI PowerNet’s operations on Crown land. This option envisaged an access charge or fee would be paid by the asset owner for the (statutory) right to access Crown land. This option required further work by the DTF to determine its legal viability as well as whether it would gain approval from the ACCC for any pass through of costs. Again, it would take a considerable amount of work to determine exactly how much land would be subject to such a charge and hence what the charge should be to raise the desired amount of revenue.

Surveying the shortlisted options before them, it was now the task of the DTF project team to bring forward its preferred proposal for final approval. Each one involved some degree of further exploration by the Department and its experts and although

they had a further three months to deliberate, there was no guarantee that they would get all of their questions answered in time.