Hazelwood: Cleaner Coal, or Dirty Deed?

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1. Introduction

On 2 September 2005, the State of Victoria entered into a "Greenhouse Gas Reduction Deed" with the owners of the Hazelwood Power Plant, marking the culmination of negotiations on the conditions under which the State would grant Hazelwood a mining licence over additional coal deposits.[1]

For the past two years, Hazelwood has been seeking regulatory approvals to proceed with its West Field Project, an expansion of the coal mine at the plant that would allow its continued operation through about 2031. Environmental organisations have strenuously opposed the project, urging that the plant be phased out as soon as possible because of its very high levels of greenhouse pollution.

The Government has touted the Deed as the first time a facility in Australia has been subject to an overall cap on greenhouse pollution, and asserted that it will result in a reduction in pollution of some 34 Mt CO_2-e over the lifetime of the facility. The pollution cap is not the only novel feature of the Deed, however. Less noticed but of potentially far greater import are the special contractual rights that Hazelwood has received regarding the development of any future emissions trading scheme in Australia.

2. History and environmental effects of Hazelwood Power Plant

Hazelwood was commissioned progressively between 1964 and 1971, and was slated for closure in 2005 by the State Electricity Commission of Victoria, its original owner. However, as part of the State's privatisation of electricity infrastructure in the 1990s, Hazelwood was sold for approximately $2.36 billion to a private consortium in 1996. After buying out some other members' interests, London-based International Power plc currently owns 91.8% of the plant, with the Commonwealth Bank Group owning the remaining 8.2%.

The current owners have stated that, at the time of purchase, their expectation was that they would have sufficient coal to operate the plant for 40 years, although the State's actual contractual commitments in this respect are not clear.

Under private ownership, Hazelwood's electricity production and absolute pollution levels increased substantially, although refurbishment in 1996-97 improved the efficiency of the plant somewhat. By all accounts Hazelwood is both a low-cost generator of electricity, in financial terms, and a very highly polluting facility in environmental terms.

According to plant statistics, Hazelwood emitted 17.6 million tonnes CO_2e in 2004,[2] or just over 3% of Australia's total greenhouse pollution from all sources. Hazelwood's pollution intensity in 2002 was 1.54 tonnes CO_2-e/MWh sent out.[3] This is the worst in Australia, if not the worst in the OECD.[4] For comparison, emissions from other brown coal-fired plants are as low as 1.15 tonnes CO_2e/MWh, emissions from combined-cycle gas-fired plants are about 0.4 tonnes CO_2e/MWh, and direct emissions from wind, solar, and hydro generation are zero.[5]

1 The full text of the Deed is available at http //www doi vic gov au/doi/doielect nsf/2a6bd98dee287482ca256915001cff0c/a795856be1dd7d1eca2570730027c933/$FILE/HazelwoodDeed pdf

2 See Final Panel Report, Hazelwood West Field EES, La Trobe Planning Scheme Amendment C32, p 174, available at http //www dse vic gov au/shared/ats nsf/webviewdisplay?openform under "Latrobe" and "C032"

3 Id

4 See WWF Australia, "Hazelwood - the dirtiest power station in the world?", referenced 23/9/05, available at http //wwf org au/News_and_information/Features/feature34 php Updated figures may indicate that Hazelwood's efficiency is slightly better than the Edwardsport, Indiana facility, making Hazelwood the second-most polluting facility in the OECD

5 See Hugh Saddler, Mark Diesendorf, Richard Denniss, "A Clean Energy Future for Australia", March 2004, pp 107, 155, available at http //www wwf org au/News_and_information/Publications/PDF/Report/clean_energy_future_report pdf

3. Procedural background to the Deed

To enable continued access to coal past 2009, Hazelwood planned the West Field Project, an extension of coal mining through deposits both within and outside of its current mining licence Among other approvals, the project requires

(1) planning scheme amendments under the *Planning and Environment Act 1987* involving the relocation of sections of the Morwell River and the Strzelecki Highway, required both for access to coal within Hazelwood's existing licence, and for access to new coal, and

(2) a mining licence under the *Mineral Resources Development Act 1990* for the new coal deposits Throughout most of the assessment process, it was estimated that these deposits amounted to about 92 million tonnes of coal, but this was revised downward in 2005 to 47 million tonnes

Without these approvals, Hazelwood has stated that it would have to close sometime between 2009 and 2011 If it obtained the planning amendments but not the licence, it would have sufficient coal to operate at current production rates until about 2026 With the new mining licence, its life could be extended through 2031

The interaction of these two statutory processes in relation to what is, in reality, a single project was confused and frequently frustrating to both the company and the project's opponents The planning scheme amendment process is a public process involving the preparation of a environmental effects statement (EES), the convening of an expert panel and broad community consultation The grant of a mining licence, in contrast, is a decision of the Minister, with very limited scope for public input and no explicit environmental impact assessment requirements

Formally, the "Greenhouse Gas Reduction Deed" is the result of closed-door negotiations between Hazelwood and the Government on the conditions that would attach to a new allocation of coal In practice, the conditions have often been viewed as a way of satisfying environmental concerns in the open, consultative planning amendment context as well

For example, the planning amendments entailed the convening of an expert panel under both the *Environment Effects Act 1978* and the *Planning and Environment Act 1987* However, the Minister for Planning instructed the panel not to consider greenhouse emissions from the plant, on the basis that those environmental issues were being taken into account in the mining licence negotiations

> *In Australian Conservation Foundation v Minister for Planning, the Victorian Civil and Administrative Tribunal found that this limitation on the Panel's inquiry was beyond the Minister's powers, and instructed the expert panel to consider greenhouse emissions from the plant* [6]

The Panel itself, convened to report on the planning amendments, did not limit itself to those issues Instead, it recommended that that the new mining licence be granted, and supported the proposed Deed to be entered into in connection with the new licence as a "reasonable way forward in the short term" The Panel did not give any clear recommendation on what environmental improvements should actually be required of Hazelwood in the Deed While apparently accepting a contemplated reduction in emissions of 25 Mt CO_2-e pollution over the lifetime of the plant, the Panel also noted that adherence to government policy would suggest a much greater reduction in pollution of around 55 Mt CO_2e [7]

The use of the Deed, negotiated in confidence, to satisfy environmental concerns in the public planning process left the project's opponents shadow-boxing for much of the dispute This is because the key terms of the Deed were outlined only in very general terms during the public consultation processes, and the final Deed diverged from that outline in concept and in its details

6 [2004] VCAT 2029 (29 October 2004),

7 See Panel Report, note 2, at pp 179 180

4. Key features of the Deed

4.1 Contractual character

Clause 1 states that the purpose of the Deed is to "give legally binding effect" to the agreement to reduce greenhouse emissions from the plant Clause 8 1 further specifies that the deed has "full legal effect and is binding on and enforceable against both Parties in accordance with its terms " These and other provisions of the Deed indicate a clear intent by the parties to create a legally binding contract

The operative provisions of the Deed do not enter into force until all conditions precedent are satisfied These conditions, as set out in clause 6, include the granting of the planning amendments and the new mining licence The conditions are expressed as being for Hazelwood's benefit, though curiously it is Hazelwood, not the State, that is required to use best endeavours to satisfy the conditions

4.2 Greenhouse pollution cap

The Deed nominally limits Hazelwood's greenhouse emissions to 445 Mt CO_2-e over its remaining life Clause 2 1(b) indicates an intent that the State be able to seek an injunction preventing the further operation of Hazelwood's boilers once it reaches this level

The idea of a lifetime pollution cap is indeed a novel approach in Australia, and at first blush the cap might appear to be a fairly extraordinary commitment However, 445 Mt CO_2e is a vast quantity Without any improvement in its current efficiency, Hazelwood could run at current production until the beginning of 2030 before reaching the cap [8]

Further weakening the cap are the following qualifications

- The cap applies to emissions only from Hazelwood's current boilers, not the plant as such While replacing one or two of Hazelwood's eight boilers would be an expensive undertaking, if done the emissions from new boilers would not count against the cap The Deed contains no restrictions on the efficiency of any new boilers

- The Deed allows for "credits" if International Power Australia develops renewable energy projects in Victoria A credit is allowable if International Power Australia is the "lead developer" of a renewable energy project and holds at least half of the equity interests at the completion of construction The amount of the credit during the first ten years depends on International Power Australia's level of equity interest in the project at the point of completion Thereafter, further credits are available if International Power Australia retains an equity interest

  The number of credits for wind farm developments over the next five years is specified as 1 tonne CO_2-e for each MWh of generation For example, if International Power Australia developed a wind farm on the scale of the Challicum Hills – a facility generating about 140,000 MWh/year – Hazelwood would receive a total credit of perhaps 1 4 Mt CO_2-e for the first ten years of operation In other words, for purposes of the cap, 1 4 Mt of Hazelwood's pollution would not be counted

  For other renewable energy developments, Hazelwood's credit is to be "agreed between the Parties", or resolved through the dispute resolution procedures The lack of any guiding principle about how credits should be determined is a major point of ambiguity and potential dispute under the Deed

  In environmental terms, these provisions do provide a incentive for International Power to invest in renewables However, the effect may be to displace other investors rather than to drive a net increase in renewable energy investments In particular, the ten-year reward period for such developments may lead to International Power Australia being a nominal developer of turnkey projects that are sold upon completion to the "real" investors In such a case, Hazelwood could get the benefit of ten years' of credits with no real risk exposure to the project

  In any event, the offset could effectively neutralise the environmental benefit of any renewable energy project, since Hazelwood will be able to pollute more in proportion to the pollution notionally saved by the renewable project

8 Based on total annual emissions of 17 6 Mt CO2 e/year

- Aside from renewable energy investments, if Hazelwood otherwise "considers that it ought to be entitled to a credit, the Parties must negotiate in good faith whether such a credit should be allowed and, if so, the amount of any such credit". Again, with no principle to further specify when such credits would be justified, this is a vague clause. Situations in which Hazelwood might claim entitlement to additional credits could include revegetation projects, research and development efforts and support for "clean coal" projects, or even investment in renewable energy outside of Victoria.

- Under clause 3(g), if any future greenhouse gas regulation allows credits for particular circumstances, the Parties must negotiate in good faith as to whether such credits should be allowed under the Deed as well.

4.3 Greenhouse pollution reductions

Separate from the cap, Hazelwood has two additional obligations relating to reducing its greenhouse pollution. First, the Deed sets targets for Hazelwood to reduce its emissions over four successive 6-year periods. For each period, Hazelwood is to report to the State on its emissions and, if they exceed the target for that period, explain why that is the case. Credits against the cap also apply to these intermediate targets.

Though the targets envisage a progressive reduction in emissions levels, they are not enforceable commitments. Clause 2.1(e)(ii) explicitly provides that Hazelwood has no obligation to meet the targets. If Hazelwood exceeds a target by more than 3 Mt CO_2e, the Minister for Energy may (but need not) appoint an expert to inquire into the matter. The expert may receive submissions, consult with persons he or she considers appropriate, and is to be provided all relevant documents by Hazelwood.

This inquiry is not public and, in light of confidentiality provisions in the Deed, it would appear unlikely that the report or any of the documents could be released to the public without Hazelwood's agreement. The Minister may – but is not required to – advise Parliament on what actions he or she proposes to take. However, this too is subject to the confidentiality provisions of the Deed, which may limit the extent to which the Minister can meaningfully report to Parliament.

The second obligation is set out in clause 2.2, which provides as follows:

> *Despite there being various means by which IPRH may comply with clause 2.1(a) [the greenhouse cap], to the extent that it is commercially viable to do so and as a separate obligation [Hazelwood] must use best endeavours to reduce the greenhouse emissions intensity ... of the Hazelwood Power Station.*

Unlike the targets, it would appear that this clause is an enforceable obligation, and in theory could require improvements at Hazelwood even if the plant is operating within the targets and the cap. However, the qualification of "commercial viability" of any reductions probably insulates Hazelwood from having to undertake measures that would not be economically attractive for it.

4.4 Coal swap

In return for the additional coal covered by a new mining licence, Hazelwood agrees to surrender certain coal deposits under its existing mining licence. The amount of coal to be surrendered amounts to some 168 Mt. The Government has claimed this feature of the Deed as a major environmental benefit, claiming that:

> *IPRH has a large amount of higher-cost coal in its current licence. Without an emissions cap, it could keep operating the power station for some years after the West Field is mined, using this additional coal. This would generate higher greenhouse emissions than providing the extra coal and agreeing the cap. ...*
>
> *The Government sought the return of the 168Mt of coal to put beyond doubt that there is no prospect of IPRH generating more CO2 under the Deed than under business-as-usual.*[9]

These claims should be viewed in the light of statements by Hazelwood in its EES that each of those deposits was "uneconomic" or "uncompetitive".[10] Hazelwood in any case relinquishes only 2 of the 5

9 Department of Infrastructure, "Frequently Asked Questions – Greenhouse Gas Reduction Deed with IPRH", available at http://www doi.vic gov.au/doi/doielect.nsf/2a6bd98dee287482ca256915001cff0c/6b39ad18e2801717ca25707600096671/$FILE/Hazelwood-FAQ.pdf.

10 International Power Hazelwood, "Environment Effects Statement. West Field Project", March 2004, pp. 3-12 to 3-14, available at http://www.hazelwoodpower.com.au under "West Field" → "Environmental Effects Statement".

additional coal deposits within its existing licence canvassed in the EES. Furthermore, its consistent assertions that it would close between 2009-2011 if it did not have access to the West Field seem to conflict with the Government's apprehensions that these other coal deposits could be exploited.

4.5 Interaction with other greenhouse gas regulations

The most unusual aspect of the Deed are the clauses addressing how Hazelwood's obligations under the Deed relate to any future regulation of greenhouse pollution.

The most likely form of such regulation would be an emissions trading scheme, set up and administered either by the Australian Government, or by the States in the absence of federal action. The States and Territories have already expressed in-principle support for a "cap-and-trade" scheme, under which an overall national cap on greenhouse pollution would be set, with individual polluters free to trade emissions permits under that cap.[11]

Clause 3 of the Deed contains an acknowledgement that such future regulations are a possibility, and that the Deed continues to operate even if future regulations come into force. Clause 3(d) provides that reductions in pollution achieved by Hazelwood under any such future regulation also count towards their obligations under the Deed.

To this extent, the provisions are unremarkable. Clause 3(f) is in a different category:

> *To the extent that it is able to do so, the State will ensure that the obligations of IPRH under this deed are reasonably taken into account in the design of any Future Greenhouse Gas Abatement Scheme and IPRH is treated equitably under such a scheme, including without limitation, by making representations to the Commonwealth where relevant. [Hazelwood] acknowledges that this clause 3(f) is not intended to constrain the State in the design or operation of a Future Greenhouse Gas Abatement Scheme.*

This clause is rich with ambiguity and contradiction. The first sentence appears to contain both a procedural obligation – that Hazelwood's obligations under the deed be "taken into account" in the design of a scheme – and a substantive obligation that Hazelwood be treated "equitably" under such a scheme. Both obligations are qualified by "to the extent that it is able to do so".

An initial problem is to whom the State's obligation applies. The development of future greenhouse gas regulation would almost certainly require legislative action, so that the first sentence, read by itself, appears to apply to matters within the competence of the Victorian Parliament. Realistically, however, a cross-jurisdictional emissions trading scheme would entail negotiations among the States and Territories as a precursor to state legislation, and so the clause is equally addressed to the Premier and Ministers who are likely to be involved in such negotiations.

One major source of interpretive difficulty is how to assess whether a scheme treats Hazelwood "equitably". Inevitably, any scheme of general application will almost certainly disparately affect Hazelwood, since Hazelwood is the least efficient plant. Does a scheme which puts Hazelwood at a competitive disadvantage, or which is more costly for Hazelwood to comply with than other power generators, treat Hazelwood "inequitably"? Perhaps not, but much may ride on the method of allocating emissions permits.

For example, one can imagine a scheme that allocates two blocks of permits as follows: (1) permits at no cost ("grandfathered" permits) to existing electricity generators, based on their existing generation levels and assuming a pollution rate of 1.0 Mt CO_2-e/MWh; and (2) a further block of permits to be auctioned generally. Would this treat Hazelwood equitably? The plant would almost certainly argue that it does not, on the basis that emissions from low-pollution plants are given all of the permits they need for free and some extra permits to sell on the open market, while Hazelwood has to pay for some of its permits.

The ambiguity inherent in the word "equitably" could plainly give rise to a dispute. But what would follow if the State designs a scheme that Hazelwood feels is inequitable to it?

11 See State and Territory Premiers and Chief Ministers, "Communiqué on National Emissions Trading Scheme", available at http://www.cabinet.nsw.gov.au/greenhouse/emissionstrading

This brings us to the core difficulty in clause 3(f): the first sentence appears to contradict the second. If the intent is not to constrain the State in the design of future regulation, then what can the obligation to seek to treat Hazelwood "equitably" in the design of such a scheme mean? On the one hand, the State appears compelled to refrain from adopting a scheme that treats Hazelwood inequitably, to the extent it can, yet it is expressly not constrained in how it designs a scheme.

One possible resolution of this apparent contradiction is to conclude that, while the State can not be *enjoined* from adopting an scheme that does not seek to treat Hazelwood equitably, if such a scheme is adopted Hazelwood may have a claim for damages. This reading obtains some support from clause 10.1, which provides as follows:

> *10.1 Acknowledgement*
>
> *[Hazelwood] acknowledges, in the context of clause 3(f), that:*
>
> *(a) one basis on which the State may introduce a Future Greenhouse Gas Abatement Scheme is to provide [Hazelwood] with financial incentives to comply with equivalent or greater obligations than those specified in this deed; and*
>
> *(b) the entitlement of the State to so legislate does not limit any other right of the State under this deed or at law in respect of a breach by [Hazelwood] of its obligations under this deed.*

The explicit reference in clause 10.1 back to clause 3(f) suggests that 10.1 is setting out one way in which the State may fulfil its obligation to seek to treat Hazelwood equitably in the design of any scheme, without directing impinging on the design of such a scheme.

Read together, clauses 3(f) and 10.1 neither establish a firm claim for damages in the event of future greenhouse emissions regulation, nor do they foreclose such a claim. Though the qualifications on the State's obligations in clause 3(f) are significant, if a future emissions trading scheme has a sufficiently serious effect on Hazelwood, the possibility of a claim for damages for breach of clause 3(f) cannot be ruled out. As a consequence, it is reasonable to think that the clause could practically limit how far a future government is willing to go in regulating greenhouse pollution.

Aside from future emissions regulations, the Deed does not specify how it relates to the existing Victorian Protocol for Environmental Management (Greenhouse Gas Emissions and Energy Efficiency in Industry) (PEM (GGEE)). The expert panel recommended that Hazelwood's obligations be in addition to those under the PEM(GGEE).

4.6 Research and development

Clause 4.2 requires Hazelwood to support low-emissions brown coal technology. The primary obligation is that Hazelwood must supply coal at a "commercially viable" price, as well as other services, to a low-emissions demonstration plant located on Hazelwood's property.

4.7 Enforcement

Clause 15 of the Deed specifies that no party may commence legal proceedings without following the dispute resolution procedures set out in that clause. "Good faith negotiations" are an initial step, and if those are unsuccessful either party may refer any dispute to "expert determination". If such a referral is made, the dispute is to be resolved by an expert, acting as such and not as an arbitrator, and the determination of the expert is to be "final and binding on the Parties" in the absence of "manifest error".

The expert's powers to impose penalties and/or injunctive relief are not clear. The Deed provides for financial penalties to be imposed on Hazelwood if it exceeds the pollution cap, as well as an expressed intent that the State be able to enjoin Hazelwood from continuing to operate over the cap. It seems most likely that the expert would have the power to make factual determinations as to the amount of penalties due, or as to whether the preconditions for enjoining Hazelwood's continued operation have been met, but formal enforcement of these determinations would have to be by subsequent application to a court.

4.8 Accountability and oversight

Both the expert panel and the Minister for Planning recommended that Hazelwood be required to report publicly, at least in summary form, on its performance under the Deed.[12] However, the Deed contains no mechanism for public oversight, monitoring or disclosure of Hazelwood's performance. Oversight of Hazelwood is solely up to the Minister.

5. Conclusion

Victorian governments have an unhappy record of entering into long-term contracts that inhibit environmentally sensible policies. One example is the State's long-term electricity supply agreement with Alcoa, though which the State subsidises Alcoa's very high electricity consumption with millions of dollars in below-market price power. Another is the CityLink contract with Transurban, in which the State is bound to indemnify Transurban if the State pursues sustainable public transport policies that would reduce revenues from Transurban's CityLink toll road.

Unfortunately, the Hazelwood contract appears to fall into this category of short-sighted deals that distort Victorian policy into unsustainable development options. Although the cap on pollution from Hazelwood is superficially innovative, the level of the cap requires little actual improvement on the part of the plant, while the qualifications on the cap and the non-binding nature of the intermediate targets render the Deed toothless.

Even more troubling, the possibility of legal claims against the State by Hazelwood may inhibit the State from efficiently and fairly regulating greenhouse pollution. Because of these potential claims, the State may well end up designing a scheme that treats all generators equitably, but Hazelwood more equitably than others.

As of the writing of this article, neither the planning amendments nor the mining licence procedures have been completed, and the operative provisions of the Deed have yet to enter into legal effect. The Australian Conservation Foundation (ACF) and others continue to oppose the granting of these approvals.

12 See Panel Report (note 2) at p 185, and Minister for Planning, "Hazelwood Mine West Field Project (Phase 2) Assessment", 1 September 2005, p 29, available at http //www dse vic gov au/dse/nrenpl nsf/FID/-D1B54196ED4691C0CA256D4F002E1551?OpenDocument