



COAG WORKING GROUP ON CLIMATE CHANGE AND WATER

Discussion Paper

**Treatment of electricity-intensive,
trade-exposed industries under the
expanded national Renewable
Energy Target scheme**

Making a submission

The COAG Working Group on Climate Change and Water invites interested stakeholders to comment on the treatment of electricity-intensive, trade-exposed industries under the expanded national Renewable Energy Target scheme. The Working Group is particularly interested in any data and other information in support of comments.

Submissions should be provided by 13 February 2009 to:

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Copies of this paper are available on the Department of Climate Change website at www.climatechange.gov.au. Hard copies are available on request.

Inquiries about this paper may be directed to:

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Confidentiality

It will be assumed that submissions are not confidential and may be made publicly available. If you would like your submission, or any part of it, to be treated as confidential, please indicate this clearly when forwarding your submission.

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1. Background

1.1 Introduction

The Mandatory Renewable Energy Target (MRET) scheme is designed to increase the deployment of renewable energy in Australia's electricity supply. It guarantees a market for additional renewables-based generation (backed by a legislative obligation), using a mechanism of tradable renewable energy certificates (RECs). One REC is equivalent to one megawatt-hour (MWh) of renewable energy.

Demand under the existing MRET is created by legally obliging parties who buy wholesale electricity (retailers and large users) to source an increasing percentage of their electricity purchases from renewables-based generation in the form of annual targets that ramp up to 9500 GWh in 2010 and remain at that level until the measure concludes. Liable parties can acquire and surrender RECs to demonstrate compliance. Alternatively, they can pay a shortfall charge of \$40/MWh.

The right (or eligibility) to create RECs is separate from the obligation on wholesale electricity purchasers. RECs can be generated both by commercial-scale renewables-based power generators, and smaller-scale wind power, hydro, and rooftop photovoltaic systems and solar water heaters.

The Commonwealth Government has committed to implementing an expanded national Renewable Energy Target (RET) scheme that will:

- ensure the equivalent of at least 20 per cent of Australia's electricity supply—approximately 60 000 gigawatt-hours (GWh)—is generated from renewable sources by 2020;
- increase the MRET to 45 000 GWh to ensure that together with approximately 15 000 GWh from existing renewable capacity, Australia reaches the 20 per cent target by 2020;
- bring both the national MRET and existing state-based targets into a single national scheme;
- count only renewable energy towards the target and keep the same eligibility criteria as in the current MRET scheme;
- phase out the RET between 2020 and 2030 as emissions trading matures and prices become sufficient to ensure a RET is no longer required; and
- retain the eligibility of all renewable energy projects that have been approved under existing state-based schemes.

The design of the RET scheme is being developed in cooperation with the states and territories through the Council of Australian Governments (COAG) Working Group on Climate Change and Water (the Working Group).

The Minister for Climate Change and Water, as Chair of the Working Group, released a public consultation paper *Design Options for the Expanded National Renewable Energy Target Scheme* on 2 July 2008. The paper sought stakeholder views on two broad approaches to the design of the RET. The period for submissions closed on 30 July 2008. The paper and submissions can be accessed via the Department of Climate Change website at www.climatechange.gov.au.

The consultation paper indicated that the treatment of trade-exposed electricity-intensive industries under the national RET would be considered in the context of decisions around the treatment of trade-exposed, emissions-intensive industries under an emissions trading scheme and would be subject to a

separate consultation process.

On 15 December 2008, following extensive consultations around the Green Paper, the Government released a White Paper which articulates the Government's position on treatment of emissions-intensive, trade-exposed (EITE) industries under the Carbon Pollution Reduction Scheme.

To distinguish between industries and activities that are emissions-intensive and trade-exposed (EITE) in the context of the Carbon Pollution Reduction Scheme, and those industries that are trade-exposed and affected by the RET, we will refer to the latter as RET-Affected, Trade-Exposed (RATE).

1.2 Focus and intent of this discussion paper

This discussion paper outlines the policy context and identifies key design dimensions to be considered in determining the treatment of RATE industries under the RET scheme. The paper also outlines three broad options for the form of assistance to be provided to RATE entities, as well as options for a materiality threshold to identify RATE entities and the level of assistance to be provided.

This document is being released by the Working Group to stimulate discussion and elicit views and information from businesses and community stakeholders.

Following COAG consideration of a RET scheme design, Commonwealth legislation will be amended and an exposure draft released for consultation. It is intended that the amended legislation will be in place by mid-2009.

2. The Issue

2.1 Should assistance be provided?

There is a threshold question of whether assistance should be provided to industries affected by the RET scheme. It could be argued that changes in industry cost structure flowing from government policies, for example changes in wages policy or occupational health and safety standards are not unusual. Assistance is not usually provided to offset the impact of such domestic policy changes on traded industries. While there would be benefits to assisted industries, these would need to be weighed against the potential impact on non-assisted industries and households.

The Commonwealth Government's current MRET scheme does not exempt or otherwise assist trade exposed electricity-intensive or other end-use industries. The issue was considered during development of the MRET and under the statutory review of the scheme in 2003, but net impacts were not considered sufficient to warrant special assistance.

The larger target commitment for 2020 under the RET will increase the electricity cost impact. The RET is likely to impact most upon electricity-intensive industries that are unable to pass through the full costs associated with the RET, for example where prices are set in international markets. A decision on whether or not to provide assistance for RATE industries, and at what level, would need to be informed by an assessment of the extent and the materiality of cost impacts.

Some stakeholders have expressed concern about higher costs. Others have expressed a view that wholesale electricity prices may fall as a result of downward pressure on electricity pool prices from the early entry of large amounts of low short-run marginal cost generation under the RET, resulting in a smaller increase in retail prices than would otherwise have been the case.

The expanded RET scheme is being designed to subsume existing and planned state and territory schemes, and some of these schemes already exempt, or contemplate exempting, certain electricity-intensive industries. The Victorian scheme legislation allows specified electricity purchases to be exempt. Exemptions have been granted for electricity purchases relating to Victoria's two aluminium smelters. Under the proposed New South Wales scheme, the state Energy Minister can designate certain trade-exposed, electricity-intensive users as exempt at his or her discretion. The draft scheme's documentation indicates that the aluminium, pulp and paper and chemicals industries would be considered in this context.

The Commonwealth Government has given extensive consideration to the treatment of EITE industries in the context of the Carbon Pollution Reduction Scheme. As outlined in the White Paper, the Commonwealth Government has decided to provide EITE assistance to those industries that are significantly exposed to the carbon price and are constrained in their ability to pass through these costs because of competition from competitors in countries less constrained by carbon pricing.

In the context of the Carbon Pollution Reduction Scheme, the aim of such assistance is to reduce carbon leakage (where EITE industries relocate offshore and use similar or more highly emissions-intensive fuels or technologies resulting in no environmental gain) in the period before broadly comparable carbon constraints are applying internationally, and provide transitional support to EITE industries that will be most severely affected by the introduction of a carbon constraint.

As the Carbon Pollution Reduction Scheme and the RET scheme differ in some important respects, this will influence the design dimensions of any assistance. For example:

- the Carbon Pollution Reduction Scheme is the centrepiece of Australia's economy-wide approach to transforming the economy to reduce the emission of greenhouse gases, while the RET is a complementary measure designed to accelerate the deployment of renewable energy.
- the Carbon Pollution Reduction Scheme is intended as an ongoing initiative to manage Australia's emissions over the long term, whereas the RET is a transitional measure to be phased out after 2020.

In order to stimulate discussion and seek information from stakeholders, the remainder of the paper seeks views on the design of assistance arrangements, should assistance be provided to trade-exposed industries materially affected by the RET.

Question: Stakeholders views are invited on the effects of the expanded RET on RATE industries and whether Government assistance is warranted?

2.2 Design Approach

In its White Paper, the Commonwealth Government extensively discussed the range of design issues considered in deciding how assistance would be provided to EITE industries under the Carbon Pollution Reduction Scheme and provided its decision on each design element.

Rather than revisiting for the RET the full range of issues associated with designing assistance to trade-exposed industries, this paper draws on a number of the basic design elements outlined as Government decisions in the White Paper:

- Level of assessment for eligibility – This will be based at an activity level rather than at the industry, company or facility level. This approach will enable more accurate targeting of assistance and will be more equitable within and across industries.
- Measure of materiality of the carbon cost impost – the White Paper indicated that the level of emissions to revenue is to be the primary way in which eligibility for assistance is assessed, however entities may request that an alternative value added metric be applied.
- Definition of trade exposure – The White Paper indicated that assistance is only to be provided to activities that have either a trade share (defined as the ration of imports and exports to the value of domestic production) greater than 10 per cent in 2005/06, 2006/07 or 2007/08; or a demonstrated lack of capacity to pass through costs due to the threat of international competition.
- Allocations to entities undertaking an eligible activity– the White Paper explained that allocations will be based on an industry-wide baseline of emissions intensity for each activity; each entity's output of that activity; and the applicable assistance level for that activity.

If assistance is to be provided to RATE industries, there are a number of more specific design elements that require further consideration. The Working Group envisages that within the set of potentially eligible activities, only those expected to experience a material impact on costs as result of the increase in electricity prices associated with the expanded RET would be eligible for assistance. Taking into account the specific features of the RET, the remainder of the discussion paper focuses on:

- the form in which RATE assistance could be provided;
- the materiality threshold level; and
- the level of assistance that could be provided to activities.

These design elements are further considered in Sections 3 to 5 below.

Question: Stakeholders' views are invited on an appropriate design approach to assisting RATE industries. Are there other key design elements that should be considered?

3. Form of Possible Assistance

A common issue to be considered in implementing any option is that some RATE industries may be protected from electricity price increases as they have long term electricity supply contracts. A key consideration will be the specifics of the contractual arrangements and which party incurs the increased costs of compliance with the RET scheme. The Commonwealth Government would need to make assistance conditional on access to the details of relevant long-term contracts. A second issue arises with respect to whether the terms of these contracts should be made public in line with normal standards of accountability for the expenditure of public funds.

3.1 Option 1: No assistance

One option is to provide no assistance to RATE industries. This would be consistent with their treatment under the MRET scheme.

Should a decision be taken to provide assistance, it could take different forms. Assistance to RATE industries could be provided through exemptions from liability under the RET scheme; the free provision of RECs; or direct cash payments. These options have different implications for administrative simplicity, transparency and the impact on other, non-assisted electricity users.

3.2 Option 2: Exemptions

A legislative exemption could be put in place to exclude electricity purchases relating to specified RATE activities from liability under the RET. An advantage of this approach lies in its administrative simplicity. On the other hand, to meet the Government's target, an increased cost burden would be imposed on the remaining liable parties. Higher electricity costs would be borne by businesses and households. For example, exempting one third of wholesale purchases, and redistributing this over the remaining two-thirds of purchases, would effectively increase the RET impact on non-assisted electricity users by an average of 50 per cent. Legislative exemptions also tend to lock in support and are less transparent than assistance funded from the Government's annual budget.

Some RATE activities could be assisted by exempting electricity purchases for which the RATE entities would be directly liable under the RET. While relatively straightforward to administer, an exemption that only assisted firms that purchase their electricity from the wholesale market pool would not assist those that buy retail electricity for RATE activities. Providing only this direct form of exemption could further increase the electricity price impacts on unassisted RATE activities, distorting the sector market.

Given that many RATE entities buy retail electricity, they may face price increases as retailers pass through their higher costs. Although administratively more complex, it may also be possible to put in place arrangements with electricity suppliers to exempt wholesale purchases where the electricity is sold on to RATE industries under contracts that allow pass through of the associated RET compliance burden.

It would be possible to grant partial exemptions under both of the above sub-options if it is decided to provide less than full assistance to RATE entities (see discussion in section 5 below). However, this would add to administrative complexity.

3.3 Option 3: Free issue of RECs

The price of RECs reflects the additional electricity costs faced by the RATE entity. Providing assistance through the free issue of RECs accommodates variations in the REC price, which would otherwise be reflected in higher electricity prices.

Under this option, the Government could purchase RECs on the market (such as through a competitive tender process), and supply them periodically to eligible RATE entities. Firstly, the RECs could be used to help RATE entities to meet their direct RECs liability. Secondly, if the RATE entity buys electricity through a retailer the entity could sell the RECS on the market to cover the higher electricity cost.

This approach provides a direct link between the level of assistance and the impact of the RET as reflected in REC prices, thereby reducing administrative costs and providing greater business certainty.

Compensation through Government-purchased RECs, while adding to Government budget costs, avoids increasing the burden on non-protected entities and their customers, which is an inherent disadvantage of exemptions. That said, such purchases will result in a burden on general taxpayers.

In implementing this option, the Government's entry into the market as potentially a large purchaser of RECs would need to be managed carefully to minimise the market impact of this activity.

Partial assistance would be more easily accommodated under this option.

To preserve transparency, information on REC allocations could be made publicly available, along with their estimated value.

3.4 Option 4: Cash payments

Direct financial assistance in the form of cash payments is a transparent way of providing assistance, with the financial burden falling on general taxpayers. Like free allocations of RECs, this approach can more easily accommodate decisions to provide partial assistance.

However, cash payments do not provide a direct link between the level of assistance and the impact of the RET as reflected in REC prices. This means that payments would need to be based on forecast RECs prices or some form of average REC price, which may not reflect the price paid by an individual entity.

Stakeholders' views are sought on the above options for the form of assistance to be provided to RATE industries. Are there any other forms of assistance that should be considered?
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4. Level of materiality threshold

While the Carbon Pollution Reduction Scheme affects the price of emissions-intensive inputs more broadly, the RET scheme's impact is focused on the price of electricity. Assessing materiality for assistance under the RET therefore requires a specific, electricity-related threshold test. Electricity intensity of production, would serve as an appropriate indicator of materiality for comparison across different areas of industry in determining RATE activities. As indirect electricity-related emissions are included in the assessment of EITE industries under the Carbon Pollution Reduction Scheme, assessment of RATE industries could utilise the EITE assessment data relating to electricity use, reducing administrative costs for all parties.

Within the set of potentially eligible activities only those expected to experience a material impact on costs as result of the increase in electricity prices associated with the expanded RET would be eligible for assistance.

In determining assistance under the RET it is proposed that there be two threshold tests:

1. Only eligible EITE activities as defined for the Carbon Pollution Reduction Scheme would be potentially eligible for assistance under the RET scheme.
2. Within this set of activities only those expected to experience a material impact on costs as result of the increase in electricity prices associated with the expanded RET would be eligible for assistance.

Preliminary analysis of electricity intensities at industry level, expressed per unit revenue (See **Attachment A**), indicates that aluminium stands out strongly as the most substantial electricity intensive industry, being an order of magnitude higher than the next rung of industries. Any costs imposed under the RET scheme are likely to rise gradually as annual targets ramp up to 45 000 GWh in 2020. The analysis, based on 2001-02 data and assuming that RECs trade at a constant price of \$40, shows the relative impacts of the gigawatt-hour targets in 2013 and 2020. It indicates that the RET cost as a proportion of revenue in 2013 would be in the order of 1.5 percent for the aluminium industry, rising to around 4 percent in 2020. This contrasts with the next rung of industries where the RET burden would rise from around 0.2 percent in 2013 to around 0.4 percent in 2020, which represents a very small cost impact, of similar order to that resulting from wage claims and regulatory changes. Australia's six aluminium smelters consume 10 to 15 percent of Australia's electricity and would bear a similar proportion of the total RET burden. As suggested by the preliminary analysis, an electricity intensity threshold of 5 000 MWh per \$ million of revenue would include activities in the aluminium industry and perhaps a small number of other similarly electricity-intensive activities.

Through the Green Paper process and subsequent consultations, the Commonwealth Government sought specific data and information from stakeholders on potential EITE activities to assist in making decisions on the EITE assistance policy that were announced in the White Paper. Where appropriate, this information will also inform consideration of assistance to RATE industries under the RET scheme.

Stakeholders' views are sought on the appropriate form and level of the materiality threshold for assistance to be provided to RATE industries, including alternative models for determining threshold eligibility?

We encourage stakeholders who consider they will be materially affected under the RET scheme, and who have not responded as part of the Green Paper consultations, to provide details of the electricity intensity of their activity as outlined in **Attachment B**.

5. Level of Support to RATE activities

In considering the level of assistance for RATE entities, a high level of assistance would provide the most insurance against loss of production in assisted industries. However, this needs to be balanced against higher impacts on non-assisted industries and households.

The cost of assistance could be significant. As indicated in Section 4 above, Australia's aluminium smelters alone would bear 10 to 15 percent of the total RET burden.

While administratively more complex, partial assistance would reduce the cost impact of providing assistance to affected industries.

It should also be recognised that the 45 000 GWh target for 2020 includes the current 9 500 GWh MRET target, and that no assistance is provided under the MRET. All electricity users are currently facing the impact of the existing MRET on electricity prices. As such, assistance would be aimed at the additional impact of expanding the current MRET. In providing assistance for this additional impact, options could include full assistance, at a rate of 100 percent, or partial assistance at a lower level. Any increases in retail energy prices could drive end users toward greater energy efficiency, making 100 percent reimbursements possibly inappropriate.

Costs of renewable technologies may also decrease over time as new technologies come on line and technological advances are made, with potential lower costs flowing to the RET.

The level of assistance to RATE industries could be varied or reduced over time.

In the White Paper, the Commonwealth Government indicated that assistance to EITE industries under the Carbon Pollution Reduction Scheme will be transitional, and that the level of this assistance will be reduced over time to ensure these industries contribute to the national abatement effort.

While the Carbon Pollution Reduction Scheme is an ongoing initiative, it should be noted that the RET scheme is a transitional measure that is already scheduled to phase out between 2020 and 2030.

Stakeholders' views are sought on the appropriate level of assistance to be provided to RATE industries and the appropriate period of time for that assistance to continue?

6. Next steps

This paper is part of a public consultation process on the development of the expanded national RET scheme. Responses to this paper will contribute to the formulation of a preferred design for the scheme.

Following analysis of submissions and targeted consultations around this paper, and informed by consultation around the approach to providing assistance to EITE industries under the Carbon Pollution Reduction Scheme, the COAG Working Group on Climate Change and Water will finalise an approach to the treatment RATE industries under the RET for presentation to COAG.

6.1 Timing

The legislative and regulatory amendments necessary to implement the design of the RET will be drafted and an exposure draft released for consultation in late 2008. It is expected that the necessary legislation will be in place by mid-2009.

It is anticipated that final RET scheme regulations, including the final list of eligible RATE activities, would be made later in 2009, following passage of the legislation. This timeframe would be compatible with a date of 1 January 2010 for the expanded RET scheme to come in to force, noting that the first liabilities under the expanded scheme would not crystallise until early in 2011.

ATTACHMENT A

Preliminary Analysis of Electricity Intensities by Industry

Industry code	Industry	Electricity use in GWh (MWh x 1000) for 2001-02 (Note 5)	Domestic Production (\$'000) for 2001-02	Electricity intensity MWh / \$million for 2001-02	Electricity cost \$'000 (Note 1)	Electricity cost as proportion of total revenue for 2001 -02	RET costs - 2020 target \$million (Notes 2, 3)	RET burden as % of revenue - 2020 target (Note 3)	RET costs - 2013 target \$million (Notes 3, 4)	RET burden as % of revenue - 2013 target (Note 3)
2702*	Aluminium	27,989	4,147,457	6,749	1,119,570	27.0%	168	4.0%	73	1.8%
2602	Ceramic products	839	1,176,357	713	33,559	2.9%	5	0.4%	2	0.2%
2605	Other non-metallic mineral products	636	1,147,520	554	25,424	2.2%	4	0.3%	2	0.1%
2303	Pulp, paper and paperboard	1,040	2,146,521	484	41,593	1.9%	6	0.3%	3	0.1%
2702*	Other Non-ferrous metals and products	5,919	12,836,830	461	236,779	1.8%	36	0.3%	15	0.1%
2701	Iron and steel	5,263	12,263,387	429	210,507	1.7%	32	0.3%	14	0.1%
1302	Non-ferrous metal ores	5,476	13,014,518	421	219,024	1.7%	33	0.3%	14	0.1%
2603	Cement, lime and concrete slurry	535	1,423,320	376	21,391	1.5%	3	0.2%	1	0.1%
2702*	Alumina	2,794	8,310,658	336	111,756	1.3%	17	0.2%	7	0.1%
2502	Basic chemicals	2,440	7,679,772	318	97,581	1.3%	15	0.2%	6	0.1%
2603*	Ready-mixed concrete	695	2,270,606	306	27,783	1.2%	4	0.2%	2	0.1%
1101*	Black Coal	4,330	14,425,215	300	173,204	1.2%	26	0.2%	11	0.1%
6201	Rail, pipeline and other transport	1,875	9,212,652	204	75,011	0.8%	11	0.1%	5	0.1%
2601	Glass and glass products	305	1,648,063	185	12,203	0.7%	2	0.1%	1	0.0%
2604	Plaster and other concrete products	474	2,693,965	176	18,961	0.7%	3	0.1%	1	0.0%
2302	Other wood products	749	4,646,980	161	29,973	0.6%	4	0.1%	2	0.0%
1101*	Brown Coal	109	689,254	158	4,344	0.6%	1	0.1%	0	<0.1%
2304	Paper containers and products	692	5,117,772	135	27,665	0.5%	4	0.1%	2	<0.1%
1301	Iron ores	657	4,900,994	134	26,283	0.5%	4	0.1%	2	<0.1%
2705	Fabricated metal products	937	7,278,957	129	37,482	0.5%	6	0.1%	2	<0.1%
2110	Beer and malt	412	3,249,987	127	16,466	0.5%	2	0.1%	1	<0.1%
2806	Electronic equipment	364	2,910,679	125	14,554	0.5%	2	0.1%	1	<0.1%
2201	Textile fibres, yarns and woven fabrics	313	2,510,031	125	12,537	0.5%	2	0.1%	1	<0.1%
2105	Flour mill products and cereal foods	456	3,670,503	124	18,236	0.5%	3	0.1%	1	<0.1%
2101	Meat and meat products	1,845	14,905,497	124	73,789	0.5%	11	0.1%	5	<0.1%

Source: Analysis conducted by The Department of Climate Change using electricity-related emissions and domestic production data sourced from the Centre for Integrated Sustainability Analysis, University of Sydney 2008 using the Australian Bureau of Statistics (ABS) Australian National Accounts Input-Output Tables 2001-02. Electricity-related emissions and domestic production for each sector was obtained using generalised input-output analysis and are consistent with Kyoto Accounting in terms of the coverage of greenhouse gases and sectoral treatment. These intensities are calculated under a basic prices valuation in terms of final demand and are strictly provided for the comparison of sectoral performance. They are not applicable to carbon footprinting of companies, projects, investment funds and portfolios, households or consumers. This analysis was conducted prior to the release of 2004-05 input-output tables. Further assumptions underpinning this analysis are in the notes below.

Notes:

* Denotes input-output sectors which have been disaggregated

1. Assumes industries pay wholesale electricity prices, and assumes a wholesale price of \$40/MWh in 2001-02

2. Assumes REC price of \$40 imposed on 15 % electricity used

3. Based on electricity intensity, electricity price and revenue for 2001-2.

4. Assumes REC price of \$40 imposed on 6.5% electricity used

5. Assumes emissions factor of 0.93 tonnes CO2-e per megawatt-hour electricity consumption.

ATTACHMENT B

Provision of data and information to assist in consideration of the treatment of RATE industries under the RET scheme

A considerable amount of data has already been provided to the Commonwealth Government in the period between the release of the Green Paper and the White Paper. Much of this information was provided on a commercial-in-confidence basis. If you have provided data and information through this process and are happy for it to be used in consideration of the treatment of RATE industries under the RET scheme, please advise that this is the case.

Please indicate clearly if you wish this information to be treated as confidential.

The following information is requested for entities that have not already provided this information to Government. Any data provided should relate to production in 2006–07 and 2007–08 if available:

- descriptions of potential RATE activities, including details of the boundaries that delineate these activities from other on-site activities and alternative boundaries that could be applied
- the electricity consumed by the activity
- the quantity of output produced by the activity
- the market price, domestic and/or international, of the output for the activity
- if internationally priced, details of where the market price is set.

The Government would prefer that the information provided be verified by a third party and that the details of the verification process are also provided. Information provided with verification will be given greater weight.

Any queries on the nature or form of data to be provided should be directed to the Renewable Electricity Markets Team, Renewables, Offsets and COAG Branch in the Department of Climate Change.
(Phone: 02 6274 1957; Email: RET@climatechange.gov.au)