



Australian Government

Enhancing the Renewable Energy Target

Discussion Paper

March 2010

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INFORMATION FOR RESPONDENTS

Key Dates

26 March 2010	Discussion paper available on the Commonwealth Department of Climate Change and Energy Efficiency Website
14 April 2010	Submissions on discussion paper due

Submission Guidelines

These guidelines outline the requirements for submissions on this discussion paper:

1. Submissions are invited from all interested stakeholders;
2. Submissions should utilise the **Submission Template** provided on the website to address the questions raised in this discussion paper. Additional comments are also welcomed;
3. Where possible submissions should be lodged electronically to the email address below, preferably in Microsoft Word or other text based formats. Alternatively, submissions may be sent to the postal address below to arrive by the due date;
4. **Submissions will not be treated as confidential** and may be made publicly available. If a submission (or extracts of a submission) is to be kept confidential, please indicate this in the **Submission Template**; and
5. All submissions are due **close of business 14 April 2010**. The Government reserves the right not to consider late submissions.

Submissions should be sent to:

Email: RET@climatechange.gov.au

Address: Renewable Energy Team
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Contact details

Copies of this paper are available on the Department's website at www.climatechange.gov.au.

Hard copies are available on request via telephone: 02 6159 7410 or email RET@climatechange.gov.au.

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1 Introduction

On 26 February 2010, the Government announced changes to the Renewable Energy Target (RET) scheme. From January 2011, the existing scheme will be separated into two parts – the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET).

These revised arrangements will deliver on the Government's 20 per cent by 2020 Renewable Energy Target. The changes will enhance the scheme by:

- encouraging the deployment of large-scale power generation using Australia's abundant renewable energy sources such as wind, solar, biomass and geothermal energy through the LRET; and
- supporting households, businesses and community groups looking to play their part in the move towards Australia's low pollution future by installing renewable energy systems like rooftop solar panels and solar hot water systems through the SRES.

The intention of this discussion paper is to outline the Government's policy on the new RET design and to seek stakeholder views on key implementation aspects. Following consideration of feedback on this discussion paper, the Government intends to introduce legislation into Parliament, with the new arrangements to commence on 1 January 2011.

2 Background

2.1 The current design of the Renewable Energy Target

The current RET scheme is intended to ensure that 20 per cent of Australia's electricity supply comes from renewable sources by 2020. The RET encourages the deployment of both large and small-scale renewable energy technologies, such as wind farms, solar, geothermal or hydroelectric power as well as household solar panels and solar water heaters.

The RET creates a guaranteed market for additional renewable energy deployment using a mechanism of tradeable Renewable Energy Certificates (RECs).

Demand for RECs is created by a legal obligation that is placed on parties who buy wholesale electricity, namely retailers and large users of electricity. Liable entities are required to source an increasing percentage of their electricity purchases from renewable energy to meet annual targets which are legislated in gigawatt-hours (GWh) of renewable energy. One REC is generally equivalent to one megawatt-hour (MWh) of renewable energy. Liable entities can acquire and surrender RECs to demonstrate compliance. Alternatively, they are required to pay a shortfall charge of \$65/MWh with effect from the 2010 compliance year.

The supply of RECs is created by renewable energy power stations using eligible sources including wind, large-scale solar, hydro-electric and in the future geothermal power, as well as small generation units including small-scale solar panels, small wind turbines and micro hydro systems, and solar and heat pump water heaters.

2.1.1 Solar Credits

The RET also includes additional incentives for small-scale renewable energy installations. Solar Credits provides support to households, businesses and community groups that install small-scale solar photovoltaic (PV), wind and micro-hydro systems by multiplying the number

of RECs that can be created for eligible installations. This support is provided as an upfront financial incentive through the deeming arrangements which allow owners of these small-scale systems to create at the time of installation RECs equivalent to the output of up to 15 years operation, depending on the system type.

With Solar Credits, if a system is installed between 9 June 2009 and 30 June 2012, the owner will receive five times as many RECs as under the standard deeming arrangements. The Solar Credits multiplier reduces to four for systems installed from 1 July 2012 to 30 June 2013 and continues to reduce linearly each year until it discontinues from 1 July 2015.

2.1.2 Waste coal mine gas eligibility

Waste coal mine gas (WCMG) is included as an eligible source under the existing RET scheme but is not a renewable energy source and does not contribute to the 20 per cent target for renewable energy in 2020.

The eligible electricity generation from existing WCMG capacity will be included in the new design, and will be captured as separate annual targets up to 2020 (425 GWh in 2011 and 850 GWh each year from 2012 to 2020).

The Council of Australian Governments' (COAG) Review of Specific RET Issues (see Section 4) is also considering whether electricity generation from *new* WCMG capacity should be eligible under the RET.

2.1.3 Assistance for emissions-intensive trade-exposed activities

The RET scheme and regulations currently provide for a legislated partial exemption from liability to all activities that would qualify for emission-intensive, trade-exposed (EITE) assistance under the Carbon Pollution Reduction Scheme (CPRS) in respect of:

- 90 per cent of their expanded RET liability above 9,500 GWh that applies to electricity used in activities defined as highly emissions-intensive; or
- 60 per cent of their expanded RET liability above 9,500 GWh that applies to electricity used in activities defined as moderately emissions-intensive.

The increased costs associated with the expansion of the RET has two components. First, if the REC price increases above the level of around \$40, then the increased REC price increases the cost impact of meeting the previous liability of 9,500 GWh. Second, the higher annual targets under the expanded RET increase the costs associated with the RET.

Accordingly, contingent on the passage of the CPRS, additional assistance is provided under the RET for eligible EITE activities by adjusting the partial exemption to ensure that the same assistance rate (either 90 per cent or 60 per cent) applies to the increase in costs associated with the previous liability of 9,500 GWh due to the REC price exceeding \$40.

Detail on the provision of EITE assistance under the new RET arrangements is provided in section 7.3.

3 Overview of changes to the RET

From January 2011, the existing RET scheme will be separated into two parts – the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET).

Together these two parts will deliver on the Government's 20 per cent by 2020 target. The changes will enhance the RET by providing greater certainty for households, large-scale renewable energy projects and installers of small-scale renewable energy systems like solar panels and solar water heaters.

Combined, the new LRET and SRES are expected to deliver more renewable energy than the existing 45,000 gigawatt-hour target in 2020. The degree to which the 20 per cent target is exceeded will depend on the uptake of small-scale technologies by households, small business and community groups.

The LRET's 41,000 GWh target for 2020 has been set to achieve a level of large-scale renewable electricity generation above what was expected under the existing Renewable Energy Target. The LRET portion of the target will be increased to ensure the 45,000 GWh target is still met in 2020 if the uptake of small scale technologies is lower than anticipated, but the annual LRET targets will not be reduced if uptake of small-scale technologies is greater than anticipated.

The new SRES will deliver households, small business and community groups \$40 for each REC created by small-scale technologies like solar panels and solar water heaters. The number of systems receiving support under the SRES will be uncapped to ensure small-scale installers have certainty.

Existing banked RECs will be available for use in the LRET but not for the new SRES.

The Government will review the operation of the SRES in the context of the planned 2014 statutory review of the RET to ensure the fixed price for RECs remains relevant.

4 COAG Review of Specific RET Issues

Following the Council of Australian Governments' (COAG) agreement to a design for the national expanded RET in April 2009, some specific issues that required further analysis and consultation with stakeholders were referred for review, including:

- whether any new small-scale renewable technologies that are not currently eligible should be included in the RET, as well as the eligibility of heat pumps; and
- whether changes should be made to the current provisions that allow for exemption from liabilities under the RET based on self-generation, which mainly affect off-grid remote resource projects.

During passage of the RET legislation in August 2009, the Government announced in Commonwealth Parliament that the Review would also consider whether the Solar Credits or a similar mechanism under the RET should be used to provide incentives for off-grid renewable generation, and the extent to which it would benefit remote communities, particularly indigenous communities.

On 5 November 2009, the Government announced that the Review would also consider factors that may be impacting upon the Renewable Energy Certificate (REC) market in the short and long term.

In addition, as part of negotiations on the Carbon Pollution Reduction Scheme legislation in November 2009, the Government announced that the COAG review process would also consider:

- whether new waste coal mine gas (WCMG) projects should be eligible under the RET; and
- whether annual targets under the RET should be increased to offset additional RECs not backed by generation as part of the Solar Credits mechanism.

The Government considers that the LRET / SRES mechanism addresses some matters within the scope of the COAG review, namely, policy issues relating to the price of RECs on the spot market and the need to increase targets to offset RECs created as part of the Solar Credits mechanism.

The Commonwealth will continue to work with the states and territories to respond to the other issues being considered by the COAG review, namely:

- the treatment of new waste coal mine gas power generation in the RET;
- the eligibility of heat pumps and new small-scale technologies;
- self-generation exemption provisions under the expanded national RET scheme; and
- support for small-scale off-grid renewable generation in remote communities.

COAG is expected to consider the final report on the remaining review issues in 2010.

5 Small-scale Renewable Energy Scheme (SRES)

5.1 Features of the SRES that are settled

Consistent with the Government's announcement, the SRES will have the following design features.

5.1.1 Fixed Small-scale Renewable Energy Certificate (SREC) price

The new SRES has been designed to deliver households, small businesses and community groups \$40 for each REC created by small-scale technologies.

For the purpose of this discussion paper, RECs created by small-scale technologies under the SRES are referred to as 'SRECs'.

The total RET support for each small-scale unit will depend on the number of SRECs it creates, which will vary according to the type of technology and the existing deeming arrangement under the RET (which provide 5-15 years upfront support).

Under the existing *Solar Credits* initiative, for example, the new fixed price of \$40 per SREC will provide a Sydney household that installs a 1.5 kilowatt solar panel system in 2011 with an upfront subsidy of \$6,200 through SRECs. Typical domestic sized solar water heaters and heat

pumps would be eligible to create SRECs worth between \$800 and \$1,600. The number of SRECs that solar water heaters and heat pumps would be eligible to create will vary according to the model and size of the system and the geographical location. Information on the number of RECs a specific system is eligible to create is available from the Office of the Renewable Energy Regulator (go to www.orer.gov.au).

The Council of Australian Governments' (COAG) Review of Specific RET Issues is considering whether any new small-scale renewable energy technologies should be included in the RET. If any new small-scale technologies are included in the RET, they will also be eligible to create SRECs under the SRES.

5.1.2 Uncapped quantity

There will be no cap on the creation of fixed price SRECs to ensure that any installation of small-scale technologies is eligible for support under the SRES.

In addition to their LRET liability, liable entities will have a separate obligation to surrender fixed price SRECs created by small-scale systems. Liable entities will purchase fixed price SRECs in proportion to their LRET liability. SRECs from the SRES will not be able to be used to meet liability in the large-scale market.

5.1.3 Technologies included in the SRES

Eligibility for small-scale technologies in the SRES will be the same as for the current RET (noting that the COAG Review is considering the eligibility of new small-scale technologies as well as heat pumps). These are:

- small generation units
 - solar PV installations up to 100 kilowatts (kw) in capacity
 - small wind turbines up to 10 kw in capacity
 - micro-hydro electricity systems up to 6.4 kw in capacity; and
- solar water heaters and heat pump water heating systems.

Deeming arrangements and the application of the Solar Credits multiplier will remain unchanged.

5.1.4 Independent review

The Government will commission an independent review in 2012, which will include participation by the energy market bodies, to provide recommendations to the Government as to possible mechanisms for setting the fixed price for SRECs under the scheme that could apply from 1 January 2014. The review would consider:

- the development of a framework in which REC prices in the future are set by an independent regulator;
- options to ensure consistent national assistance by incorporating consideration of state and territory assistance in setting SREC prices;
- changes in the costs of the technologies; and

- the impact of the SREC price and levels of small-scale technology deployment on the electricity market, including electricity prices.

The review would also consider a framework for determining eligibility under the RET, particularly for small-scale technologies.

5.2 Implementing the SRES

In designing a mechanism to implement the SRES the Government is mindful of the need to:

- provide certainty to liable entities such as electricity retailers as to their SRES liability; and
- ensure all households and others installing a small-scale renewable energy systems are able to create and sell SRECs in a timely and efficient manner.

Under the current RET, the total quantity of RECs required to be surrendered by liable entities to the Regulator each year is fixed in the Renewable Power Percentage (RPP). The price of RECs varies to clear the market, depending on supply from renewable energy providers and demand from liable entities. It is common for the value of the REC to be factored into the purchase price of a small-scale renewable energy system as an upfront discount. The RECs resulting from a small-scale installation can then be traded on the spot or contract market.

The uncapped nature of the SRES changes the character of the obligation on liable entities. While liable entities will have more certainty about the SREC price, which will be fixed at \$40, the quantity of SRECs will be open-ended. Liable entities will be collectively obliged to purchase all the SRECs created over a given time period (e.g. annually).

It is important that electricity retailers have adequate notice of their obligations under the RET as they need to factor the cost of purchasing SRECs into electricity pricing. This is particularly important where retailers are subjected to regulated retail tariffs. In July 2009, COAG agreed to the pass-through to regulated retail tariffs of costs associated with the expanded RET.

Under the current RET, liable entities have a 12 month period to manage their REC obligation. The RPP is set before the end of March each year, with RECs needing to be acquitted by mid-February of the following year.

The timing of liable entities' obligations may also impact on the ability of households to receive their benefit in a timely manner. Under the current RET, households or businesses usually assign their RECs to installers in return for an upfront discount on the cost of installing a small-scale renewable energy system. RECs may be purchased regularly by a liable entity seeking to manage a future obligation, or an intermediary such as a broker or financial institution. Under the SRES, while SRECs will be created throughout the year, with a fixed \$40 price, there will be little incentive for liable entities to regularly purchase SRECs. It is likely that liable entities will acquire SRECs immediately before the date they are liable to surrender them to the Regulator, say in February each year. This would result in SREC suppliers or financial intermediaries covering the cash flow cost of the SRECs until liable entities are required to surrender them.

The Government is considering options that would allow households to receive the benefit of the SRECs as soon as practicable while still providing certainty for liable entities.

5.3 SRES implementation options

5.3.1 Establishing a clearing house mechanism

Under the SRES, SRECs will be created as per the current processes administered by the Regulator. The creation, transfer and surrender of SRECs will be recorded on the REC Registry as is currently the case. Information about SRECs in the Registry will be publicly accessible as is currently the case for RECs. Installers will have an incentive to provide their customers with an upfront discount on the price of installation, in exchange for transferring ownership and the value of their SRECs. Similarly, parties will still be able to trade SRECs prior to the acquittal date.

By the date of acquittal, liable entities such as electricity retailers will need to acquire and surrender a certain number of SRECs.

To create a fixed price for these SRECs, a clearing house would establish a central point for the transfer of SRECs at the fixed price. There are two models for using a clearing house to facilitate the transfer of SRECs – a compulsory model where in order for a SREC to be validly surrendered to meet an obligation, it must be cleared through the clearing house, or a voluntary model where transferring SRECs through the clearing house would be voluntary but arranged in such a manner that it provides market certainty as to the fixed price.

Under the compulsory model, the cost to a liable entity of acquiring a SREC will be \$40. The transfer of SRECs would be determined by the clearing house rules, to ensure the pool is being effectively cleared. A ‘first-in, first-out’ rule could be adopted and a mechanism for identifying or date-stamping SRECs would be needed.

If the clearing house is compulsory, once created with the Regulator, SRECs would go into the clearing house (see Figure 1 – Compulsory Clearing House). Liable entities would periodically ‘clear the pool’ at the fixed price. The clearing house would transfer ownership of each SREC at the fixed price of \$40 and would arrange for the transfer of funds from the liable entity to the SREC owner.

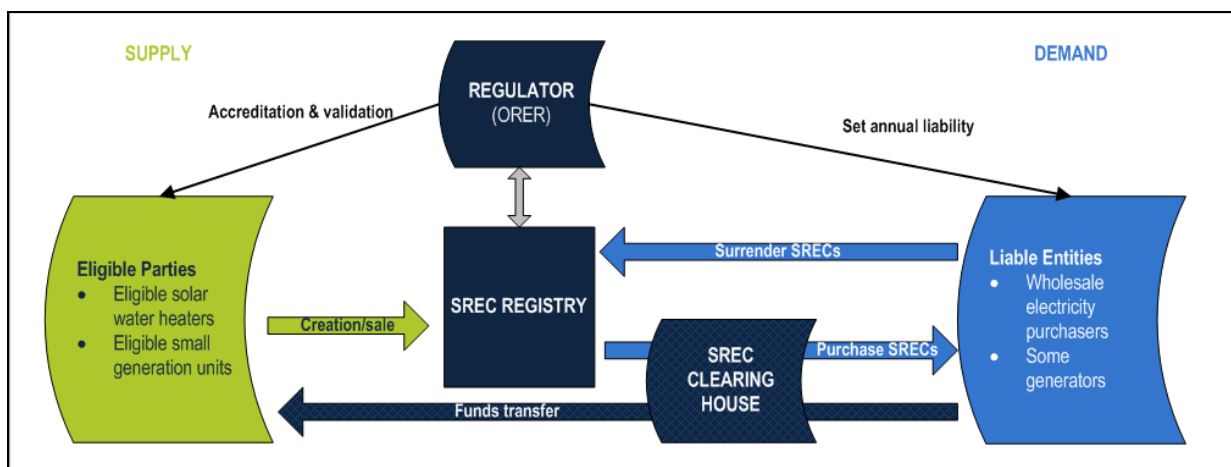


Figure 1 – Compulsory Clearing House

Under the optional clearing house model, liable entities may wish to surrender SRECs transferred to them from their customers or otherwise acquired on the market, to acquit their obligation, without going through the clearing house (see Figure 2 – Optional Clearing House). The clearing house would effectively set the market price as it would stand ready to facilitate

the transfer of all SRECs at the \$40 fixed price. The clearing house would manage the sale of all SRECs offered to it, and deliver SRECs at the \$40 price to liable entities. If there are not enough SRECs in the clearing house for liable entities to meet their SRES obligations at the end of the year, the clearing house would be able to ‘borrow’ SRECs which are yet to be entered into the clearing house or created and deliver them to liable entities at the \$40 fixed price. When SRECs are later placed in the clearing house, the \$40 that liable entities had earlier paid for the ‘borrowed’ SRECs would be paid to those who placed them in the clearing house and those SRECs would be cancelled.

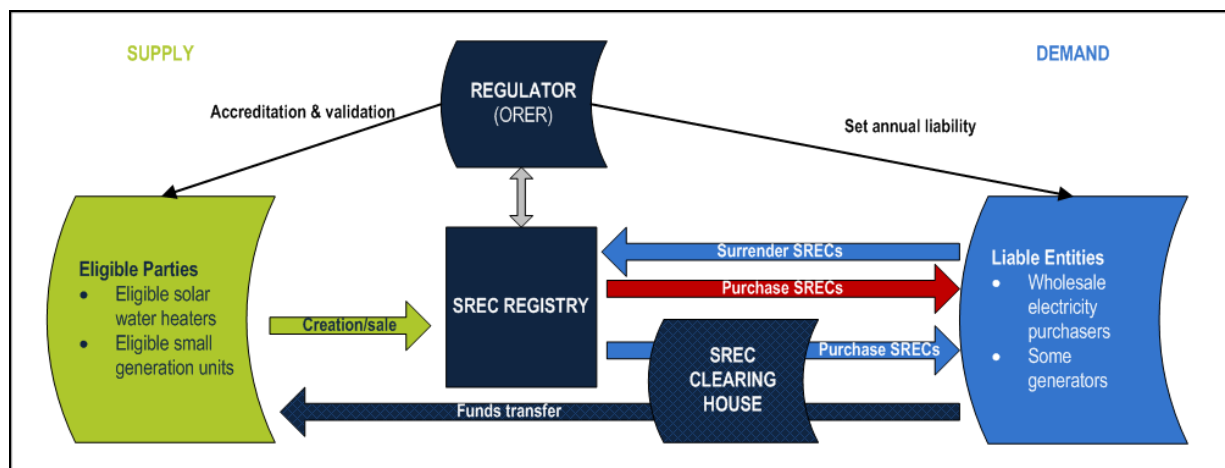


Figure 2 – Optional Clearing House

Question

Would liable entities and SREC suppliers want the flexibility of trading outside the clearing house?

5.3.2 Providing certainty to liable entities

As described in Section 5.3.1, the SRES will establish a system whereby liable entities surrender all SRECs created by the installation of small-scale technologies. Compared to the current RET, the uncapped nature of the SRES may increase uncertainty for retailers and wholesale purchasers of electricity as to their annual liability. The Government has identified two broad options to address uncertainty in the SRES.

Option One

Option one features an uncapped annual liability to ‘clear the pool’ of actual SRECs created in each year. For example, for compliance year 2011, liable entities would be advised in February 2012 of the SRES liability to clear the pool of SRECs created in 2011. This percentage would be calculated after the LRET liability for the year and the SREC creations were known (i.e. after the 14 February LRET compliance deadline). By the end of March, liable entities would collectively be required to surrender the total number of SRECs created in the previous calendar year (see Figure 3 – Example of key dates for Option 1).

For an individual liable entity, they would be required to surrender a percentage of their relevant acquisitions that is the equal to:

$$\frac{\text{Actual SRECs created in 2011 (in GWh)}}{\text{Actual relevant acquisitions in 2011}^1(\text{GWh})}$$

For example, if the total amount of all SRECs created in 2011 was 9 million (where one SREC is 1 MWh equivalent) and the total relevant acquisitions for 2011 was 220,000 GWh, a liable entity would be required to surrender the equivalent of 4.1 per cent of their individual relevant acquisitions in SRECs.

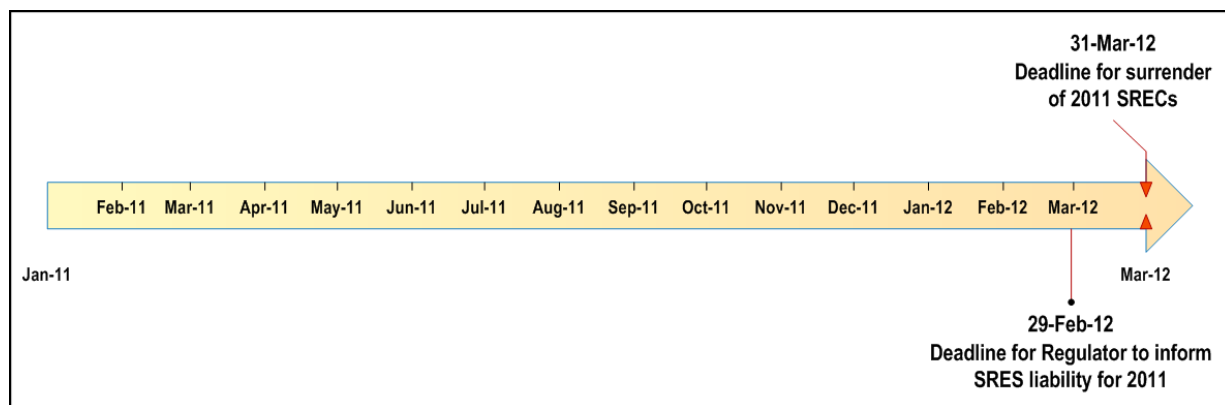


Figure 3 – Example of key dates for Option 1

Option Two

The Regulator would project a quantum of total SRECs expected to be created at the start of each year. An annual quantitative target would be set based on this projection, with a ‘smoothing’ mechanism to adjust for any underestimation or overestimation in the following year. Similar to the Renewable Power Percentage (RPP) in the LRET, this would be expressed as a percentage of the individual’s relevant acquisitions, which for 2011, for example, would be calculated by:

$$\frac{\text{Projection of the number of SRECs to be created in 2011 (in GWh)}}{\text{Total projected relevant acquisitions in 2011 (GWh)}}$$

The percentage would be calculated and published as a separate RPP each year (i.e. usually at the start of a year but no later than 31 March). Liable entities would be required to surrender SRECs to meet their obligation in the following year (2012 in the example).

The Regulator would then ‘true-up’ the projection in setting the following year’s projected quantitative target. For example, if the number of SRECs created in 2011 was one million more than the projected uptake, then the following year’s projection would be increased by one million SRECs. This example is illustrated in Figure 4 below.

¹ Relevant acquisitions refers to the total wholesale acquisition of electricity as outlined in the RET legislation. The denominator in the equation would be net of all partial exemptions provided in respect of eligible EITE activities that year. Similarly, each liable entity’s relevant acquisitions would be net of partial exemptions.

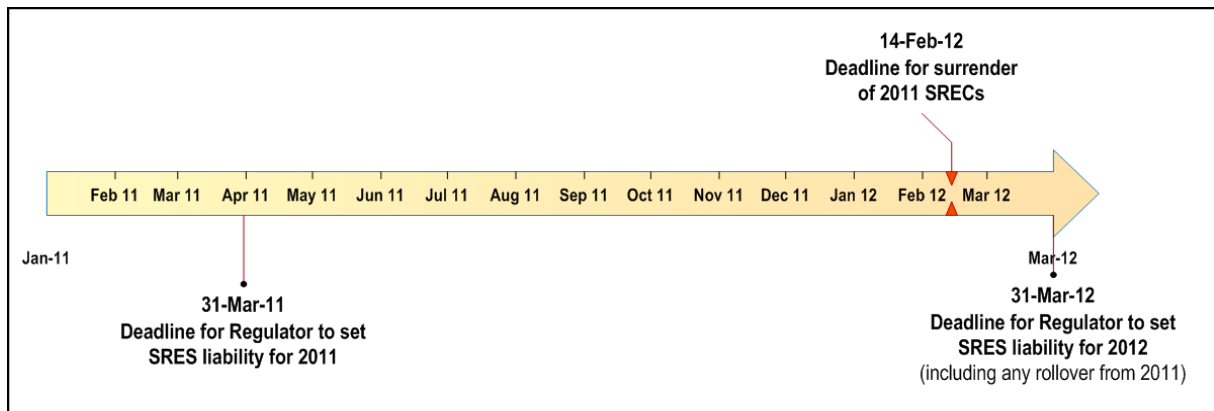


Figure 4 – Example of key dates for Option 2

The key difference between the two options is the time at which liability is established. Option 1 sets liability after the end of the year in which the SRECs are created while Option 2 would align more closely with the operation of the current RET and would provide upfront certainty to liable entities as to their future liability.

Option 1 would ‘clear the pool’ of actual SRECs created each year. However, given the uncertain liability, it would be difficult for electricity retailers to manage the risk of the uncapped number of SRECs in supply contracts and to set electricity prices when supply contracts are negotiated in advance.

Option 2 would provide liable entities with more certainty as to their annual liability upfront. They would be able to settle electricity price contracts with the certainty of knowing the quantum of their obligation over the next 12 months. While this option would provide retailers with certainty each year, they would still need to manage the risk of the uncapped quantity in the longer-term.

Under both options each liable entity’s share (i.e. their relevant acquisitions) and the ‘total relevant acquisitions’ in the percentage would be net of any partial exemptions.

Alternative option - distributor model

The two options above are based on the SRES liability being imposed on electricity retailers (and wholesale electricity purchasers), like the current RET. Early stakeholder consultations have revealed an alternative option, involving electricity distributors. The SRES obligation could be imposed on retailers but with the SRES liability effectively transferred to electricity distributors, who may have access to a mechanism to pass through costs.

This would be similar to the current treatment of state and territory electricity feed-in tariffs (FiTs). FiTs operate by placing an obligation on retailers to pay a certain rate to their customers who install solar panels. Distributors then have an obligation to reimburse retailers for their costs in complying with this obligation. Distributors treat compliance with this obligation as an input cost, and make a case to the relevant regulator to increase their network charges to recover the costs. Retailers then increase their charges to customers to recover the increased network costs.

This option may be difficult to implement in practice. It would involve a fundamental change to the nature of the obligations currently imposed under the RET by involving another party (distributors) which would likely result in an increase in transaction costs for the scheme. Other

issues that would need to be settled include the treatment of off-grid installations, the possibility of an uneven regional distribution of costs and the administrative arrangements with the Australian Energy Regulator and state-based regulators.

In addition, implementing a system of partial exemptions in respect of EITE activities under this approach would be problematic as the cost increase for EITE and non-EITE firms would depend upon the increase in network costs attributable to the obligation. The extent to which different classes of customers paid for the SRES would largely depend on the way distribution businesses allocate costs between their tariff classes. These factors create significant risks that the cost-burden of the SRES would be shared inequitably in the economy.

Given the difficulties with this option, the Government does not see it as a viable model to achieve the RET's policy objectives.

Question

The Government is seeking views on which of the options above or other options would provide adequate certainty for electricity retailers and other liable entities under the RET.

5.3.3 Ensuring the timely purchase of SRECs

Under the options described in Section 5.3.2, liable entities will be obliged to surrender SRECs annually. The obligation is a guaranteed payment, backed by Commonwealth legislation, of \$40 per SREC upon acquittal. SRECs are likely to be traded before the acquittal date at the \$40 value, less the 'cost of carry'².

The longer the timeframe between the creation of SRECs and the requirement that they be surrendered to the Regulator, the greater the time lag for owners or other holders of SRECs. The Government is exploring options to facilitate a more regular flow of SRECs from suppliers to liable entities. In particular liable entities could be required to acquit their obligations on a more regular basis, such as quarterly or six monthly, with an annual assessment of compliance to be undertaken at the same time as assessing compliance with LRET obligations each February.

Periodic surrender on a quarterly basis would provide a regular 'clearing of the pool' to pay holders of SRECs earlier than under an annual surrender period. As such, a shorter period of acquittal would transfer more of the cash flow cost from SREC holders to liable entities. This could be put in place where the annual liability is known, such as under Option 2 outlined in Section 5.3.2.

Liable entities would have certainty about the total obligation for the coming year, but would be required to acquit their obligations quarterly. Quarterly acquittals of SRECs could be established 28 days after the end of each quarter. Figure 5 below illustrates these key dates for 2011.

² Cost of carry refers to the time value of money, the opportunity cost of holding SRECs until they are required to be surrendered.

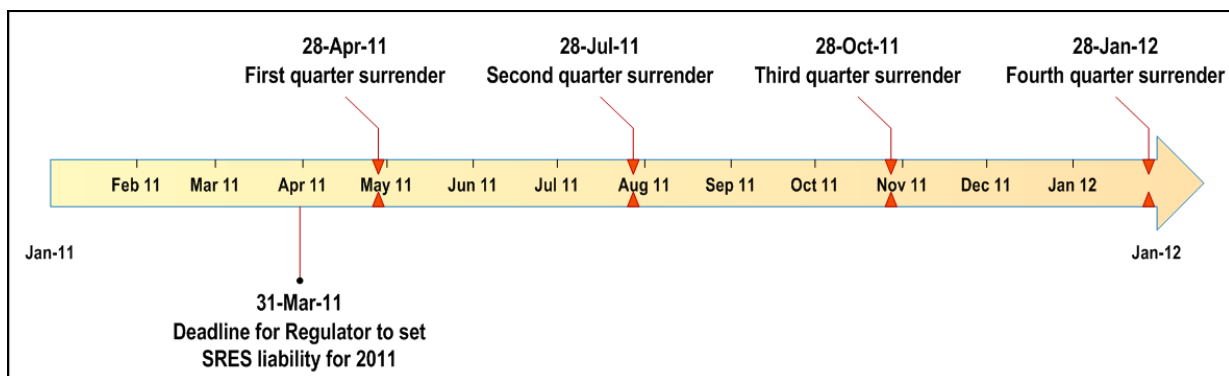


Figure 5 – Example of key dates – quarterly surrender

Questions

Would periodic surrender give SREC holders timely purchase of their SRECs?

Would quarterly surrender allow liable entities to align their SREC surrender processes with existing business requirements and pricing of electricity?

6 Large-scale Renewable Energy Target (LRET)

6.1 Features of the LRET that are settled

Consistent with the Government’s announcement, the LRET will have the following design features.

6.1.1 Revised annual targets

The Large-scale Renewable Energy Target (LRET) will include legislated annual targets starting at 10,400 GWh in 2011, increasing to 41,000 GWh in 2020 and remaining at that level until 2030 (see Figure 6 - Profile of annual targets under the LRET). The profile of annual targets under LRET will be 4,000 GWh per year less than the current annual targets (which also include renewable energy from the small-scale sector). This is to take account of the SRES component which will provide a separate mechanism for small-scale technologies which will also contribute to the overall target. The current additional generation from waste coal mine gas will continue to be additional to these targets.

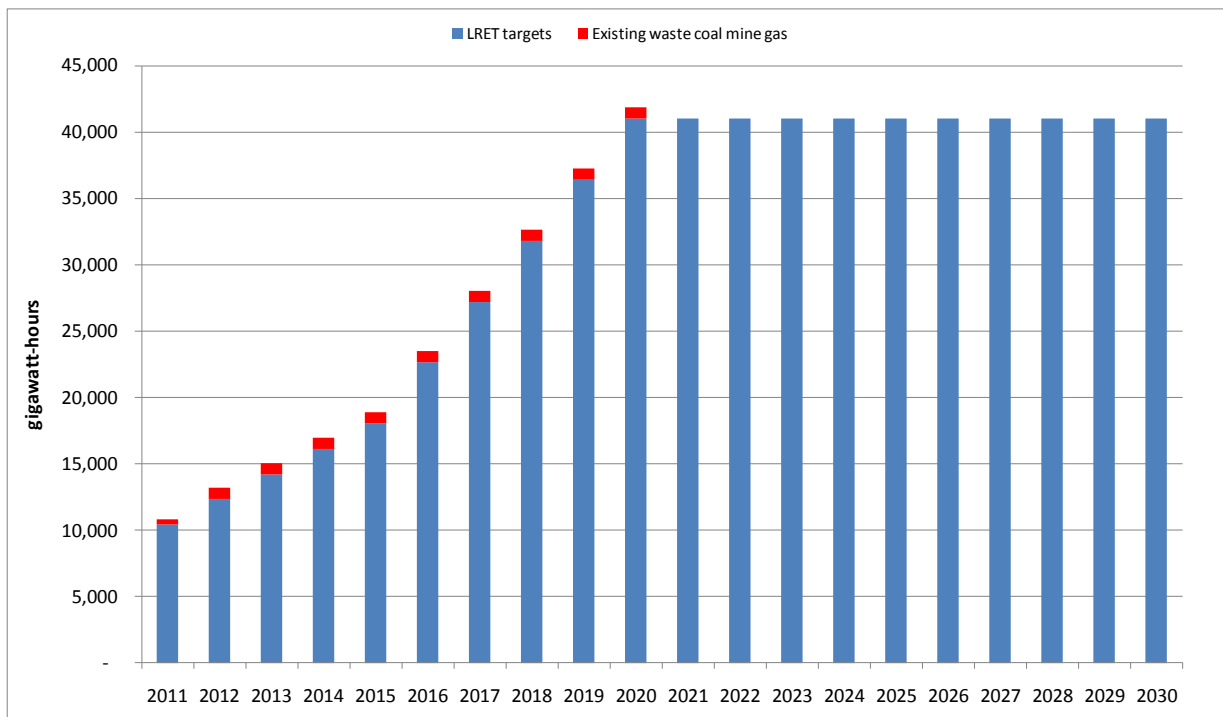


Figure 6 - Profile of annual targets under the LRET

6.1.2 REC creation

Eligibility for the LRET will be the same as that for large-scale technologies for the current RET and will include accredited power stations using eligible renewable energy sources such as wind, solar, biomass, hydro and geothermal energy. Also, existing baselines will be maintained for power stations that were established before 1997.

Existing banked RECs from the current RET will be eligible for use in the LRET. This is discussed in more detail in Section 7.1.

6.1.3 Liable entities

Liability under LRET will operate in a similar form to the current RET, with the Regulator announcing the Renewable Power Percentage (RPP) early in each compliance year to provide liable entities with an indication of the amount of RECs they will need to acquire throughout the year to meet their obligation. An individual liable entity will still determine their liability by multiplying their relevant acquisitions for the year by the RPP.

This approach will provide minimal disruption to the current operation of the RET for liable entities and large-scale generators, and will provide certainty for entities engaging in long term electricity supply contracts.

To ensure the combination of the LRET and SRES remain on track to meet the Government's commitment to 20 per cent renewable energy by 2020, the uptake of small-scale systems will be reviewed in 2014 and the target increased in the LRET if deployment of small-scale technologies is lower than expected.

6.2 Operation of the LRET

Liabe entities will still be required to meet their annual RET obligation by surrendering RECs (see Figure 7 – Operation of the Large-scale Renewable Energy Target). From 1 January 2011 only RECs from large-scale generation and banked RECs will be able to be used to meet LRET liabilities.

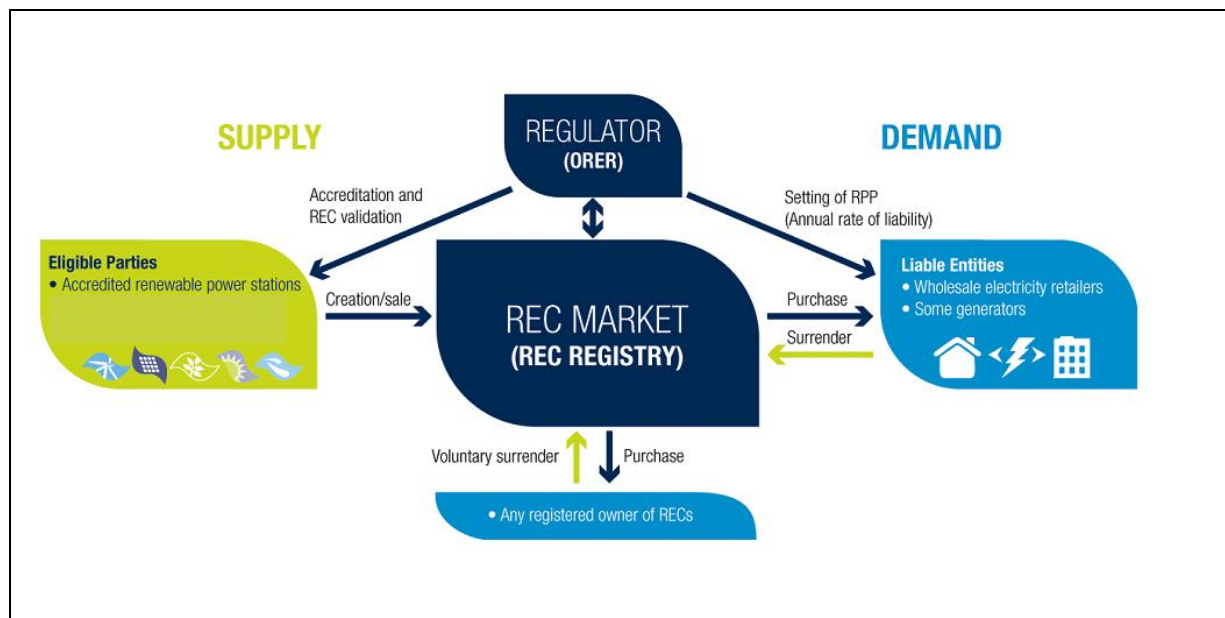


Figure 7 – Operation of the Large-scale Renewable Energy Target

It is expected that, like the RET, the LRET will involve a spot market for REC trades as well as a contractual market where liable entities and generators enter into long term contracts for RECs.

7 Other issues

7.1 Use of existing / banked RECs

The Government has decided that existing banked RECs will be able to be used by liable entities to meet obligations under the LRET, but not the SRES. This is intended to ensure that there is adequate liquidity in the LRET market, particularly in the early years of the scheme.

All RECs created from large-scale generation will be included in the LRET. In relation to RECs from small-scale installations, the Government's proposed changes to the RET envisaged that all RECs created from small-scale systems installed up to 31 December 2010 will be able to be used by liable entities to meet obligations under the LRET, but not the SRES.

Example: A person installing a small-scale system in November 2010 would have 12 months to create their RECs (as per the current rules for REC creation). If they delay creating their RECs until 2011, they need to provide the Regulator with evidence of the installation having occurred prior to the 31 December 2010 cut-off in order to have those RECs recognised in the LRET.

The stock of RECs up until 31 December 2010 is intended to provide liquidity in the LRET, which assists liable entities to manage their REC liability and meet short term obligations. The LRET targets have been set at a level for large-scale generation that is above what was expected under the existing RET. For example, while the profile of annual targets under LRET will be reduced by 4,000 GWh per year, REC creation from small-scale technologies was over 9,000 GWh in 2009.

In preliminary consultations, some stakeholders have raised concerns that there will be an oversupply of RECs in the short term if all small-scale RECs for systems installed in 2010 are eligible for the LRET and have suggested a shorter transition period. For example, some have suggested that the cut-off date for RECs from small-scale technologies to be banked and eligible for the LRET could be brought forward to 30 June 2010.

In the past, RECs from small-scale technologies have provided an important source of liquidity in the REC market. It is not unusual for the stock of banked RECs to exceed the current year's target, or that of the following year.

Constraining eligibility of small-scale RECs from 2010 would reduce liquidity in the spot market, with liable entities needing to rely more on long term contracts with renewable energy generators to meet their obligations. There would however be a risk that liable entities would default to paying the shortfall charge if there was a delay in large-scale projects coming on line and generating RECs.

With a cut-off date of 30 June 2010, small-scale installations would be relying on support from the SRES from 1 July 2010. However, under the options presented in this discussion paper, the obligation to surrender SRECs could fall in April 2011 (see Figure 5 – Example of key dates – quarterly surrender) or as late as March 2012 (see Figure 3 – Example of key dates for Option 1). As such, there would be a significant time delay for owners of SRECs until the clearing house is established to facilitate transfer of SRECs at \$40.

An alternative proposal would be to restrict banking of RECs from small-scale systems installed in 2010 such that they could only be used to meet the 2010 compliance year obligations. However, this would segment the pricing of RECs and would not change the overall supply of banked RECs able to be used in the LRET to the extent that liable parties meet their 2010 obligation with small-scale RECs from 2010 and later use the existing stock of banked RECs to meet future LRET liabilities.

A further alternative would be to bring forward all LRET and SRES arrangements to commence from 1 July 2010. This would involve significant challenges in implementing changes in a short timeframe, including the establishment of a clearing house under SRES and changes that would need to be made to the REC Registry.

Implementation with an earlier cut-off date would also introduce changes part way through the 2010 compliance year, where liable entities have already made arrangements to manage their REC obligations based on the current rules for the creation of RECs, including from small-scale systems.

7.2 Treatment of existing forward contracts

Some participants in the market have entered into contractual arrangements to transfer RECs at a future date. These contracts, including REC price parameters, were entered into based on the policy framework of the current RET, which includes a variable price. Generally, the Government does not wish to intervene in these contractual arrangements.

It is likely that any such contracts simply refer to ‘RECs’ rather than being tied to RECs specifically from small-scale or large-scale generation (e.g. I agree to transfer you 20,000 RECs in 2013 at a price of \$42 per REC). Where a power station (e.g. under a power purchase agreement) or financial institution has agreed to the transfer of RECs, the rules for the creation and transfer of RECs for the LRET would not impede these agreements being met. As all banked RECs will be available for the LRET, contracts to re-purchase RECs previously created from small-scale or large-scale generation are also unlikely to be impacted.

However, where the contract involved RECs that were to be created from small-scale technologies after 1 January 2011 it may have been assumed that the person obliged to transfer those RECs would create them from the installation of small-scale generation or solar hot water heaters and the recipient would, under the new arrangements, be seeking them in relation to the LRET market (either to meet their liabilities or to supply to another person in that market).

As a transitional measure, it is intended that where it can be demonstrated that such contractual agreements are in place, RECs that are to be created from small-scale generation or solar hot water heaters will be valid for use in the LRET. The contracts need to have been entered into before 26 February 2010 (the date the changes to the RET were announced).

To achieve this outcome, either party to a contract that involves supply of RECs after 1 January 2011 will be able to apply to the Regulator to have their contract recognised as a ‘relevant pre-existing contract.’ To be a ‘relevant pre-existing contract’ the contract must:

- have been entered into on or before 25 February 2010;
- relate to the transfer of RECs after 1 January 2011;
- involve a certain quantity of RECs that were to be supplied and created from a small generation unit or a solar water heater after 1 January 2011

If approved as an eligible pre-existing contract:

- the person obliged to supply the RECs would apply to the Regulator to convert a certain quantity of the SRECs to RECs for the LRET which are necessary to comply with their obligations under the contract; and
- the converted SRECs would not be able to be used to meet SRES obligations.

Question

Views are sought on the proposed approach for recognition of ‘pre-existing contracts’.

7.3 Assistance for emissions-intensive, trade-exposed (EITE) entities

7.3.1 The framework for EITE assistance in the current RET

In implementing the LRET and SRES, the Government’s intention is to preserve the effective rate of assistance in respect of EITE activities provided for under the current RET.

Under the current RET, legislated partial exemptions are applied to all activities that would qualify for EITE assistance under the Carbon Pollution Reduction Scheme (CPRS). Regulations providing the detail of that assistance under the RET were made on 10 March 2010 and can be found at: <http://www.orer.gov.au/eites/index.html> .

The partial exemption policy recognises that the increased costs associated with the 2009 expansion of the RET has two components. First, if the REC price increases above the level of around \$40, then the increased REC price increases the cost impact of meeting the previous liability of 9,500 GWh. Second, the higher annual targets under the expanded RET increase the costs associated with the RET.

The policy, as agreed when the 2009 amendments were made, is to provide a base rate of assistance (known as ‘base k’ in the regulations) in respect of:

- 90 per cent of the expanded RET liability above 9,500 GWh that applies to electricity used in activities defined as highly emissions-intensive; or
- 60 per cent of the expanded RET liability above 9,500 GWh that applies to electricity used in activities defined as moderately emissions-intensive.

Additionally, following the passage of the CPRS, regulations will provide additional assistance under the RET for eligible EITE activities by adjusting the partial exemption to ensure that the same assistance rate (either 90 per cent or 60 per cent) applies to the increase in costs associated with the previous liability of 9500 GWh of the RET due to the REC price exceeding \$40. This is known as the ‘additional assistance percentage’ in the regulations.

Assistance is provided through a legislative partial exemption from liability to:

- entities undertaking EITE activities that are directly liable under the RET; or
- electricity retailers supplying electricity to entities undertaking EITE activities.

The exemption only relates to electricity used in undertaking EITE activities.

The details of the partial exemption policy can be found in the commentary to the draft regulations released in December 2009

http://www.climatechange.gov.au/en/submissions/ret_eite.aspx and the explanatory statement to the Renewable Energy (Electricity) Amendment Regulations 2010 (No 1).

7.3.2 Proposed implementation of EITE assistance under the new RET design

The obligation to acquire RECs under both LRET and SRES will continue to have a cost impact on the conduct of EITE activities. The nature of that cost impact will have changed, with:

- the difference between the 41,000 GWh LRET target and the 9,500 GWh target is less each year than it used to be under the 45,000 GWh target and the price of acquiring RECs will relate only to the dynamics of the LRET market;
- the SRES obligation is likely to impose costs relating to at least the 4,000 GWh taken off the original target, but the uncapped number of SRECs means that it may be increased by the uptake of small-scale technologies. However, the fixed price removes the price risk with these increased volumes; and
- the separation and capping of the SRES obligation at \$40 impacting the provision of assistance for when the REC price is above \$40.

7.3.3 Implementation options

It would be possible to create two different partial exemption amounts based upon the existing policy framework; one for the LRET and one for the SRES. The LRET would recognise the price impact above \$40 for the existing target and the SRES exemption would recognise the volume risk of the SRES scheme. However, the Government recognises that the complexities of two different partial exemption mechanisms may:

- introduce additional complexity for EITE firms and liable entities in determining the value of a partial exemption (imposing additional transaction costs); and
- complicate the administration of SRES (such that liability under the LRET would no longer directly determine liability under the SRES).

Accordingly, the Government would prefer to calculate a single partial exemption amount for each EITE activity and site which is then used for both LRET and SRES.

One option would be to introduce a mechanism to recalculate the assistance percentages based upon the SRECs volumes which are used to create liability under SRES. The rest of the partial exemption regulations would then continue to work as they do currently and the single 'partial exemption' in MWh would apply for both SRES and LRET liability.

For 'base k' in the EITEs regulations, the percentage would be calculated each year based upon expected SREC creation. This could be a projection by the Regulator in advance or the actual number used in creating the annual SRES target (if a target is set in advance, as under Option 2 described in Section 5.3.2). The regulations would include a 'true-up' percentage the following year if required. This would result in the 'base k' percentage being:

$$\frac{(\text{SRECs}_t + \text{LRET target}_t - 9500)}{(\text{SRECs}_t + \text{LRET target}_t)} \quad \times \quad 90\% \text{ or } 60\%$$

For instance for a highly emissions-intensive activity, if 4,000 GWh of SRECs were created in 2013 to form the collective SRES obligation, the base k would remain at 45.12% for that year (as is currently specified in the regulations). However, if 6,000 GWh of SRECs were used in 2013, base k would be $(6,000 + 15,050 - 9,500)/(6,000 + 15,050) \times 90\% = 49.38\%$. Alternatively, if a true-up was used, the percentage of 45.12% could be written into the regulations and used in 2013 (based upon 4,000 SRECs) and the additional 4.26% added for 2014 (based upon the application of the above formula by the Regulator once the SREC number was known).

The 'additional assistance percentage' would also be recalculated based upon the expected SRECs. This would essentially be:

$$\frac{9500}{(\text{SRECs}_{t-1} + \text{LRET target}_{t-1})} \quad \times \quad 90\% \text{ or } 60\%$$

As the additional assistance percentage is already calculated on the previous year's proportion of the target that is below 9,500 GWh, it will be able to be used for the assistance without a true-up mechanism. For the application of this percentage, the REC price would continue to be calculated on the basis of the volume weighted average LRET REC price. It is understood that the Regulator will need to consider the changed dynamics of the REC market in making this estimation.

Question

The Government is interested in stakeholder views on the implications of the LRET and SRES on the partial exemption regulations for EITEs and the proposed approach.

7.4 Voluntary surrender of Renewable Energy Certificates

The *Renewable Energy (Electricity) Act 2000* allows registered owners of RECs to voluntarily surrender them for any reason, for example to encourage additional generation of electricity from renewable sources above the legislated targets.

Individuals or organisations will still be able to purchase and voluntarily surrender RECs in the LRET to drive additional renewable energy generation as the LRET is still based on a quantitative target. SRECs will not be eligible for voluntary surrender.