



**Australian Government**

**Department of the Environment and Energy**

# **National Energy Guarantee**

Draft Detailed Design for Consultation

Commonwealth Elements

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## 1 INTRODUCTION

The decision of the Council of Australian Governments (COAG) Energy Council on 20 April to progress development of the detailed design of the Guarantee was an important step forward in delivering a more affordable and reliable energy system as we transition to a lower emissions future.

The Commonwealth Government has been working constructively with its state and territory colleagues and the Energy Security Board (ESB) to finalise the design of the Guarantee for determination at the next COAG Energy Council meeting in August.

The Commonwealth Government is leading the design of elements of the Guarantee related to Australia's emissions reduction targets: setting the emissions target under the Guarantee, the treatment of emissions-intensive trade-exposed (EITE) activities and the role of external offsets.

The *National Energy Guarantee Draft Design Consultation Paper* (consultation paper) was the first public consultation paper for the Guarantee that was released by the ESB in February 2018. The consultation paper included a chapter prepared by the Government on its design elements. The response to this paper, including over 150 submissions received by the ESB, demonstrated the high level of interest in the design of the Guarantee. The Government has since been undertaking detailed consideration of its design elements while continuing to engage with industry and other stakeholders.

The Guarantee is an important element of the Government's comprehensive plan for a more affordable and reliable energy system and provides for a credible and enduring emissions reduction mechanism in the National Electricity Market (NEM). The Guarantee will provide the policy certainty that industry has said it needs to continue investing in new generation post-2020. This includes investment in the dispatchable capacity needed to maintain the reliability of the system, as well as the low emissions generation needed to reduce emissions in line with Australia's international commitments.

### 1.1 This paper

This paper presents the proposed design of the Commonwealth elements of the Guarantee for consultation. Its release alongside the ESB's *National Energy Guarantee Draft Detailed Design* paper is intended to provide a complete picture of the proposed design of the Guarantee.<sup>1</sup>

The Government is seeking responses from stakeholders to the proposed design outlined in this paper, and to the specific questions it poses. The feedback received from stakeholders in response to this and the ESB's paper will be used to inform the final design of the Guarantee for determination by the COAG Energy Council in August.

The Government's proposed design of the Commonwealth elements is summarised below.

#### *Setting the emissions target*

The Government will set the emissions reduction targets in Commonwealth legislation as a table of annual emissions per megawatt hour (MWh) targets (known as electricity emissions

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<sup>1</sup> [www.coagenergycouncil.gov.au](http://www.coagenergycouncil.gov.au)

targets) for the financial years ending 2021 to 2030. The annual targets will be consistent with achieving a 26 per cent reduction on 2005 levels by 2030.

The National Electricity Law (NEL) would adopt the target set in Commonwealth legislation for the purpose of the Guarantee.<sup>2</sup>

#### *Exemption for EITE activities*

All EITE activities exempt under the Renewable Energy Target (RET) will be eligible for exemption under the emissions component of the Guarantee.

EITE entities will apply to the Clean Energy Regulator (CER) for an exemption, as they do under the RET. The application process and audit requirements will be streamlined to minimise duplication.

The CER will be responsible for determining the electricity eligible for exemption under the Guarantee. This will be based on a method established in Commonwealth legislation consistent with the 'electricity use method' under the RET.

To ensure the required emissions target is achieved, the total exempt MWhs will be shared across all non-EITE load as an adjustment to the annual load used for compliance. The ESB is consulting on the provisions for this adjustment to be included in the NEL.

#### *The role of offsets*

The Government is continuing to consider whether market customers should be allowed to use offsets to meet their obligations under the emissions element of the Guarantee. Should the Government decide they are eligible, market customers would be able to use Australian Carbon Credit Units (ACCUs) from the commencement of the Guarantee, with the Government to make a decision on the use of international units before 2020.

The Government could set a limit on the total volume of emissions that can be offset across all market customers. This could be reviewed every five years. The process for allocating the total limit into individual market customer allowances could be contained within the NEL and the National Electricity Rules (Rules). The Government could work with the ESB to develop this process.

## **1.2 Consultation process and submissions**

The Commonwealth invites submissions in response to this consultation paper by no later than **6 July 2018**. Please note that submissions in response to this paper are due one week before the close of submissions for the ESB's *Draft Detailed Design* paper. Submissions will be made public unless they are clearly marked as confidential. Submissions should be emailed to [NationalEnergyGuarantee@environment.gov.au](mailto:NationalEnergyGuarantee@environment.gov.au).

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<sup>2</sup> The NEL is a schedule to a South Australian Act—the *National Electricity (South Australia) Act 1996*. It is applied in the states and territories that participate in the National Electricity Market by the various application Acts of those jurisdictions.

## 2 SETTING AND REVIEWING THE ELECTRICITY EMISSIONS TARGET

### 2.1 Setting the emissions reduction target

The Government has previously said that the target for the electricity sector would be a 26 per cent reduction on 2005 levels by 2030. This was reflected in both the ESB's February 2018 consultation paper and the Government's subsequent *Update on Commonwealth Design Elements*. This target is consistent with the Government's commitment under the Paris Agreement, and ensures that emissions reductions in the electricity sector are balanced with the need to provide an affordable and reliable electricity supply.

The initial ten years of targets to be adopted under the Guarantee will be set in either new or existing Commonwealth legislation. The NEL would include a provision to adopt the targets set in Commonwealth legislation under the Guarantee. This will give effect to the targets in jurisdictions participating in the NEM.

#### **Box 1 Participating jurisdictions**

The ESB's initial conception of the Guarantee was intended to apply to jurisdictions participating in the NEM. The Government will continue to work with other jurisdictions that are considering adopting the Guarantee on how it could apply to them.

### 2.2 Form of the emissions target under the Guarantee

In the ESB's February 2018 consultation paper, the Government suggested expressing the electricity emissions reduction target as a trajectory of annual average emissions per MWh levels (referred to as 'electricity emissions targets'). These targets would be calibrated to meet the sector's 2030 target. Stakeholders' broad support for this approach was reflected in the Government's subsequent *Update on Commonwealth Design Elements*.

A key benefit of this approach is that the level of emissions per MWh market customers must achieve would be unaffected by changes in demand—providing market customers with certainty as to the target they have to meet. Emissions intensities of existing and new generation are comparatively more stable than demand forecasts. Total emissions, however, do depend on total electricity demand. Therefore, the Government will need to take demand projections into account when setting the electricity emissions targets to ensure the overall emissions target for the sector is met.

The Government proposes that a table of annual electricity emissions targets be included in primary Commonwealth legislation to provide certainty for investors about the level of emissions per MWh each market customer will need to achieve each year under the Guarantee. These targets would follow a trajectory consistent with reducing emissions by 26 per cent below 2005 levels by 2030.

The electricity emissions targets would be based on an emissions budget that specifies the maximum level of emissions for the 10-year period from financial year 2021 to 2030. The emissions budget would be established by following a trajectory from business-as-usual level emissions in 2020 to a point target in 2030 that equals a 26 per cent reduction on the emissions level in 2005. The emissions budget would be used to set the electricity emissions target trajectory such that the emissions budget equals the sum of the electricity emissions targets multiplied by projected electricity demand for the period 2021 to 2030. The projected level of demand would be consistent with the way the ESB determines the retail load covered by the emissions requirement of the Guarantee in its design.

The shape of the trajectory of electricity emissions targets would guide the spread of emissions reductions across the period. The emissions reductions trajectory will allow the use of limited carry forward and deferral provisions which will provide flexibility for market customers to find the least cost path.

### **2.3 Forecasts and adjustments to the target**

As discussed above, a key input to calculating the electricity emissions target in each year is the projected electricity demand for that year. Electricity demand forecasts are currently produced by the Australian Energy Market Operator (AEMO), providing a 20-year forecast of future demand levels.<sup>3</sup>The Government believes AEMO is best placed to provide demand forecasts for calculating electricity emissions targets under the Guarantee.

If actual demand differs from the forecast demand levels used to calculate electricity emissions targets, this would impact the actual level of emissions reductions achieved under the Guarantee. However, what matters is the emissions budget over time, not emission reduction in a given year. Following stakeholder consultation, one option is for the Government to take account of variations in demand when the next set of electricity emissions targets are set by 2025. If the target were changed every year based on revised demand forecasts, it may create uncertainty and impact on investment. Views are sought as to the best option available.

### **2.4 Timing and process for setting electricity emissions targets under the Guarantee**

The Government proposes to set the annual electricity emissions targets for the first ten years of the Guarantee in Commonwealth legislation. The targets would be extended by 2025 for the period 2031 to 2035 and every five years thereafter.

Setting future targets could take account of over- or under-achievement against the 10-year electricity emissions budget.

### **2.5 Geographic neutrality**

The Government remains of the view that a consistent approach across the NEM should be taken to energy policy, with a single trajectory of electricity emissions targets set under the Guarantee.

As signatory to the Paris Agreement, an international agreement between nations, the Government is responsible for setting Australia's national emissions reduction targets, and ensuring the right mix of policies is in place to achieve them.

If states and territories choose to pursue their own renewable energy targets, the Government's position is that this would not affect the electricity emissions targets that would operate under the Guarantee. The reliability requirement of the Guarantee would ensure that sufficient dispatchable generation is available across all jurisdictions, regardless of the impact of state-based targets on the distribution of investment across regions.

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<sup>3</sup> A summary of AEMO's 2018 Electricity Forecasting Insights can be found on the [AEMO website](#).

### **Issues for stakeholder consultation**

Stakeholder views are sought on:

- The Government's proposed approach to setting the initial electricity emissions targets under the Guarantee.
- The Government's proposed approach to amending targets and setting future targets under the Guarantee.

### **3 IMPLEMENTING THE EXEMPTION FOR EMISSIONS-INTENSIVE TRADE-EXPOSED ACTIVITIES**

#### **3.1 Exemptions for EITE activities**

An exemption from the emissions component of the Guarantee recognises the importance of preserving the international competitiveness of Australian businesses carrying out emissions-intensive activities.

In 2010, EITE activities were made partially exempt from the RET. In 2015, this exemption was increased to 100 per cent. Under the RET, EITE entities can transfer their exemption to their liable entity (electricity retailer) to obtain a reduction in their electricity costs for the year.

The Government maintains its intention to exempt all electricity supplied for use in carrying out an EITE activity from the emissions requirement of the Guarantee. This was previously stated in Chapter 4 of the ESB's *Draft Design Consultation Paper*, and in the Government's *Update on Commonwealth Design Elements*.

##### **3.1.1 EITE activities eligible for exemption**

All EITE activities eligible for exemption from the RET would also be eligible for the exemption under the Guarantee. Part 3A and Schedule 6 of the *Renewable Energy (Electricity) Regulations 2001* (RET Regulations)<sup>4</sup> prescribe the EITE activities that would be eligible for exemption. The *Emissions-Intensive Trade-Exposed Activity Boundaries* instrument referred to in regulation 22ZHC of the RET Regulations describes the boundaries of EITE activities published in Schedule 6, for the purpose of determining an amount of exempt electricity.

Existing EITE activities listed in the current RET Regulations would be eligible for exemption under the Guarantee.

##### **3.1.2 Administering the EITE exemption**

The CER administers exemptions for EITE activities under the RET. As such, the Government proposes retaining the CER as the regulator responsible for issuing exemptions under the Guarantee. Stakeholders were supportive of this approach in feedback to the ESB's *Draft Design Consultation Paper* on the Guarantee.

Maintaining the CER as the regulator responsible for processing exemptions for EITE activities across both the RET and the Guarantee would avoid duplicative processes and minimise administrative costs for industry and the CER. Importantly, a regulator needs to make judgements about the methodology used to calculate the exemption. Maintaining this function at the CER for both schemes would avoid inconsistencies that could arise if the exemptions were processed by different regulators.

The CER's issuance of exemptions under the Guarantee would need to be supported by the appropriate Commonwealth legislation.

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<sup>4</sup> Also known as the REE Regulations

## **3.2 Method for working out the exemption amount**

### **3.2.1 Exemption methodology**

The CER is responsible for calculating the amount of exemption under the RET. From 2020 onwards, all EITE entities are required to use the electricity use method to calculate their exemption amount (see Box 2).

The current electricity use method guidelines set out seven basic methods to determine the liable electricity used to carry out an EITE activity at a site.<sup>5</sup> In submitting an application for exemption to the CER, the EITE entity is required to provide the relevant metering details that can be used as part of a formula to calculate the exemption amount.

The Government proposes retaining the electricity use method as the method for calculating the amount of exemption under the Guarantee. In applying the electricity use method for the Guarantee, the CER would calculate the exemption with respect to the ESB's final Guarantee design. This would include consideration of how retail load is calculated within the emissions registry, including treatment of transmission and distribution losses.

A similar set of methods to those set out in the RET electricity use method guidelines would be prepared by the CER to assist applicants in preparing the relevant material for a Guarantee exemption.

In choosing the method that most accurately identifies the exemption amount for the purpose of the Guarantee, the CER would have regard to the *Emissions-Intensive Trade-Exposed Activity Boundaries* instrument, the practicalities of the method, the method applied to the EITE entity's RET exemption (if relevant) and any other relevant matters.

#### **Box 2 Renewable Energy Target electricity use method**

Amendments were made to the *Renewable Energy (Electricity) Act 2000* (RET Act)<sup>6</sup> on 14 December 2017 to include the addition of an electricity use method for calculating exemption for EITE activities. Transitional arrangements are currently in place, with all scheme participants required to use the electricity use method from 2020.

Under this method, the amount of exemption will be calculated by the CER, based on metered liable electricity that is used to undertake the EITE activity in the year. Information on how to apply this method is in the electricity use method application guidelines.

### **3.2.2 Treatment of electricity used at a site for purposes other than an EITE activity**

Most EITE entities have a portion of their electricity that is used for a purpose other than carrying out an EITE activity. As is the case under the RET (see Box 3), this part of an EITE entity's electricity would not be exempt from the emissions requirement of the Guarantee.

<sup>5</sup> Clean Energy Regulator, *Exemption certificate guideline - Electricity method*, updated January 2018.

<sup>6</sup> Also known as the REE Act.

### **Box 3 RET treatment of non-exempt electricity under the electricity use method**

The *Emissions-Intensive Trade-Exposed Activity Boundaries* instrument referred to in regulation 22ZHC of the RET Regulations describes the boundaries of EITE activities, for the purpose of determining an amount of exempt electricity.

The activity boundaries are relevant for determining whether or not electricity use at a site of an EITE activity is 'consumed in carrying on the activity' within the meaning of paragraph 22ZHC(2)(a) of the RET Regulations.

Electricity used in non-EITE activities at the site is excluded from the exempt electricity calculated in the exemption. For sites that have a mix of liable and non-liable electricity, the CER will consider that the percentage of liable and non-liable electricity consumed by each activity at the site (EITE activity or non-EITE activity) will be the same.

The CER considers the information provided by the applicant when calculating the exemption, in order to accurately reflect the electricity eligible for exemption. The explanation and justification for the approach used to determine the exemption amount is known as the electricity use method advice in the RET Regulations.

### **3.3 Process for applying for an exemption for EITE activities under the Guarantee**

#### **3.3.1 Who may apply for an exemption**

An application for exemption under the RET can be made in relation to an EITE activity to be carried out on a site. The application must be made by a 'prescribed person', as specified under Part 5 Division 1A of the RET Act. This will generally be the EITE entity carrying out the EITE activity.

The Government proposes applying a definition aligned with the definition of a 'prescribed person' under the RET for the purpose of applying for an exemption under the Guarantee. This definition would need to consider other matters relevant for the Guarantee. For example, that the site in which the EITE activity is being carried out must be in a jurisdiction in which the Guarantee applies and the applicant is a constitutional corporation or has an electricity contract with a constitutional corporation.

#### **3.3.2 Application for an exemption**

In considering the approach to exempt EITE activities, the Government is guided by the principle of minimising regulatory and administrative burden by leveraging existing processes where possible.

Recognising this, the Government proposes aligning the exemption application process under the RET and the Guarantee. EITE entities would submit a single application to the CER, indicating whether the application is to be considered for the purpose of exemption under the RET, the Guarantee or both. The application would cover the upcoming RET compliance year and Guarantee compliance year, for example, an applicant submits one application covering the 2020 RET compliance year and the 2020–21 Guarantee compliance year for a particular site.

The application would need to contain the information required to calculate the exemption under both schemes. Details beyond those already required for the RET may be required in order for the CER to accurately calculate the exemptions under both schemes. These additional details could relate to differences in the relevant exemption period under the RET

and Guarantee (calendar year and financial year respectively) and differences in the definition of electricity covered under the two schemes (for example in relation to the treatment of transmission and distribution losses, self-generation, and on-site generation).

Audit reports that accompany applications could be aligned to cover both the RET and the Guarantee (see section 3.3.6).

The Government proposes to amend Commonwealth legislation to allow EITE entities to submit a single application to the CER in order to receive exemptions under the RET and the Guarantee.

### **3.3.3 Administration process for exemptions**

The following is the high level administration process for exemptions under the RET:

- EITE entities applying for an exemption under the RET have from 1 August the previous year until no later than 30 March of the relevant RET compliance year to lodge an application for exemption with the CER.
- The CER then assesses the application and issues the exemption to the EITE entity and authorised liable entity<sup>7</sup> within 60 days.<sup>8</sup> Details of the exemption must be published on the CER website within 14 days of issuance.
- EITE entities can then transfer their exemption to their liable entity (which may be the EITE entity itself).
- The CER notifies the EITE entity and authorised liable entity of the exemption amount (in MWh) after the compliance year is complete.
- The liable entity can then use the exemption details to claim a reduction in their relevant energy acquisitions for that compliance year.

A compliance assessment of the emissions requirement would occur following the reporting deadline after the end of the compliance year, as determined by the ESB.

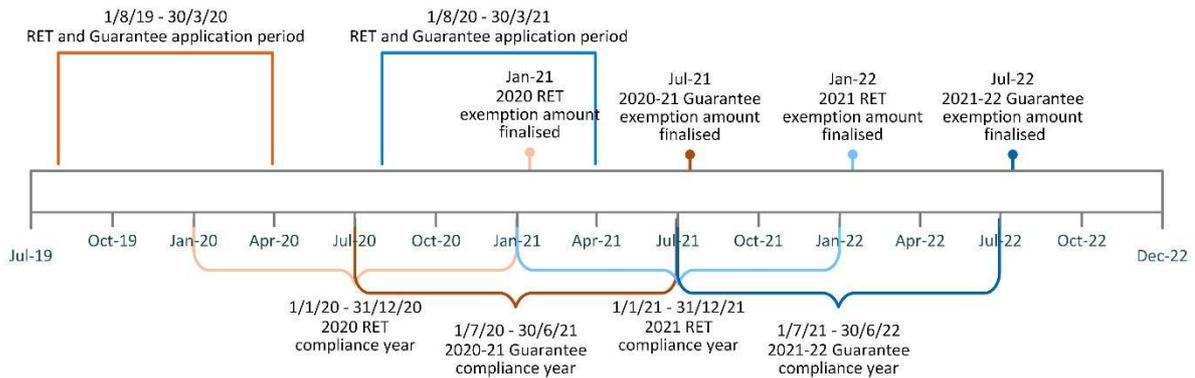
EITE entities applying for an exemption under the Guarantee would likely require similar timeframes to complete the application for exemption as they are currently given under the RET. They would also require enough time to be able to negotiate their exemption with the relevant market customer providing the EITE load.

The Government proposes retaining the current arrangements under the RET, such that EITE entities have from 1 August the previous year until no later than 30 March of the relevant RET compliance year to submit an application to the CER for exemption under both the RET and the Guarantee. The CER would then assess the application and issue separate exemptions for both schemes relating to their respective compliance year (see section 3.3.4). The exemption amount would be finalised after the compliance year has been completed (see section 3.3.5). Figure 1 outlines the proposed administrative approach.

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<sup>7</sup> An EITE entity may authorise the CER to provide exemption information directly to the liable entity.

<sup>8</sup> Under the current arrangements, if further information is sought by the CER this timeline is within 60 days of receiving further information.



**Figure 1: Proposed administrative approach for exemptions under the RET and the Guarantee**

Extending the current 60 day period for issuing an exemption may be required to allow the CER sufficient time to process applications and issue EITE entities with an exemption for both schemes.

### 3.3.4 The exemption

Exemptions for the RET and the Guarantee would be issued in relation to the relevant compliance year, the site, the scope of electricity defined for each scheme, and the responsible entity providing electricity to the site. The exemption would describe how the exemption amount would be determined by the CER after the compliance year is complete and other information as required under the RET Regulations.

The EITE entity would be able to negotiate and transfer the exemption to their nominated entity. While the final exemption amount cannot be calculated until the end of the relevant compliance year, the CER has developed a monitoring tool (see Box 4) to allow the EITE entity and authorised entity to estimate the exemption amount during the year.

#### Box 4 Estimating an exemption amount during a compliance year

For the 2018 RET compliance year, the CER made available a monitoring tool to enable EITE entities and authorised liable entities to estimate the exemption amount at any point during the 2018 compliance year.

From 2019, the CER is intending to provide EITE entities and authorised liable entities estimated exemption amounts during each compliance year through an online platform.

The estimated exemption amount should be used for monitoring purposes only. The CER will determine the final exemption amount after the end of the compliance year.

### 3.3.5 Notice of exemption amount

Under the current RET arrangements, the CER collects electricity data and determines the exemption amount for each EITE site by mid-January after the compliance year (for example, for the 2020 compliance year, this would be mid-January 2021). The CER then notifies the EITE entity and authorised liable entity of the exemption amount.

The liable entity then has until 14 February to use the exemption details in their energy acquisition statement to claim the RET exemption. The Government proposes a parallel timeframe be established for the purpose of the Guarantee after the end of the compliance year but before market customer load amounts are finalised within the registry.

### **3.3.6 Audit requirements**

The CER has an extensive audit framework in place for the programs it administers. The purpose of auditing is to optimise compliance with the laws the CER administers. The audit requirements ensure the programs are operating effectively and in accordance with the laws underpinning them.

Exemption audits are currently required under the RET Act and RET Regulations. Provisions are included in the legislation around who can prepare the audit report and the requirements of the report. Under the electricity use method (see section 3.2.1), an audit is required:

- when an applicant uses the electricity use method for the first time
- every three years
- on request by the CER.

While audits are an effective method to ensure the integrity of a policy, they can be administratively burdensome and often costly for the applicant to conduct. As such, the Government proposes that a single audit meet the audit requirements for the purposes of both the RET and the Guarantee.

The audit would cover the compliance periods for the RET (calendar year) and the Guarantee (financial year), and would be expanded to include advice on the electricity used for calculating the exemption under both the RET and the Guarantee (if they differ).

The Government proposes to amend Commonwealth legislation to prescribe that a single audit be carried out and submitted to the CER to meet the requirements of the RET and the Guarantee.

## **3.4 Applying exemptions under the Guarantee**

### **3.4.1 How exemptions are factored into market customers' emissions requirements**

With an exemption, a market customer would only be required to demonstrate it has met the electricity emissions target for the portion of its customer load that is not exempt (that is, the non-EITE load). To ensure the overall electricity emissions target can be met, all emissions from the supply of electricity in the sector need to be accounted for, including those that relate to the supply of electricity to EITE customers.

The exemption of EITE activities is a policy responsibility of the Commonwealth Government. However, the ESB is consulting on the application of the exemption to market customers' emissions requirements, as this will take effect through the NEL.

#### **Issues for stakeholder consultation**

Stakeholder views are sought on:

- Whether the proposed approach to streamline the RET and Guarantee exemption applications minimises any regulatory burden for EITE entities.

## **4 EXTERNAL OFFSETS**

### **4.1 The inclusion of external offsets**

The Government has previously said it is considering whether market customers should be able to use external offsets as a flexible compliance option to meet the emissions requirement of the Guarantee. In its *Update on Commonwealth Design Elements* the Government said it would consider the use of offsets with reference to the following design principles:

- ensuring affordability
- facilitating efficient investment, and
- promoting competition.

### **4.2 A possible approach for the use of offsets**

The Government is continuing to consider whether offsets should be allowed under the Guarantee. This paper presents a possible approach for offset use, which could be implemented if offsets were included. In developing this approach, the Government has sought to balance the views of stakeholders while maintaining consistency with the principles outlined above.

If included, the Government could cap the number of offsets that could be used across the electricity sector. This approach was flagged in the ESB's *Draft Design Consultation Paper*. This cap should be set by the Commonwealth Government, as it is responsible for the achievement of Australia's emissions reduction targets, and the contribution each sector makes towards the target.

A cap on offsets could preserve the investment signal provided by the Guarantee, as the market would have certainty about the minimum level of emissions reduction the electricity sector would contribute to meeting the annual electricity emissions targets. It could also provide certainty to offset providers about the potential demand that could come from the electricity sector.

In setting a cap, the Government would consider the principles of facilitating efficient investment and ensuring affordability. To satisfy the first, the Government could set the cap such that the majority of the activity undertaken to meet the Guarantee would occur within the electricity sector. This would enable the Guarantee to deliver its intended outcome—producing a clear investment signal for low emissions and reliable generation to get built when and where it is needed, and at the lowest cost.

The Government could set the cap either as a fixed number of offsets, or by calculating it as a percentage of the expected emissions reductions required to meet the 2030 target, such as 5 or 10 per cent.

The Government could review the use of offsets under the Guarantee in 2025, in the context of reviewing and setting the next five years of targets, and could choose to revise the cap at this point. The Government could also retain the ability to adjust the cap more frequently if required (such as setting a cap annually), although this would need to be balanced against businesses' need for certainty in managing their emissions requirements.

## **4.2.1 Which offsets could be used under the Guarantee**

### *4.2.1.1 Domestic offsets*

If offsets were to be included, market customers could use Australian Carbon Credit Units (ACCUs) to contribute towards meeting the emissions requirement of the Guarantee. Each ACCU represents one tonne of carbon dioxide equivalent emissions avoided or sequestered. ACCUs are issued by the CER for emissions reductions achieved through projects under the Carbon Farming Initiative legislation (which underpins the Emissions Reduction Fund (ERF)), which meet a set of criteria, including eligibility, additionality and newness requirements.

Given the existing controls on their quality and ongoing use in other sectors, the Government proposes that should offsets be eligible, market customers would be able to use eligible ACCUs for the purposes of complying with the Guarantee. The Government would determine the eligibility of ACCUs, such as to ensure only units which contribute to Australia's international commitments are used and that double counting does not occur.

### *4.2.1.2 Avoiding the double counting of emissions*

Businesses from across the economy can earn ACCUs through a range of eligible project types. This includes electricity generators, which can earn ACCUs by undertaking a project to reduce the emissions from the production of electricity at a power station.

If market customers were able to use certain ACCUs under the Guarantee there is a risk that some emissions reductions could be counted twice. For example, this could occur if a generator connected to a grid where the Guarantee applies receives ACCUs for reducing its emissions, then passes the ACCUs on to a market customer, which surrenders them to lower the emissions it is liable for under the Guarantee. In this way, a single tonne of emissions reduction is counted twice, once by the generator and once by the market customer.

If the Government permitted offset use within the Guarantee, it would take appropriate measures to ensure that double counting of emissions reductions did not occur. This could include excluding certain ACCUs from use under the Guarantee or changing the eligibility criteria under certain ERF methods for future projects.

### *4.2.1.3 International units*

International units could be considered for use under the Guarantee. In its *2017 Review of Climate Policies*, the Government gave in-principle support to the use of high quality international units to meet Australia's emissions reduction targets, but said it would determine when and how they can be used by 2020.<sup>9</sup> This is because the international market rules for the post-2020 period are still being negotiated under the Paris Agreement. As such, there is uncertainty regarding the future supply and price of high-quality units, although over 60 countries have indicated they intend to participate or will consider participating in their trade.<sup>10</sup>

Australia will only allow the use of units that are consistent with the rules implementing the Paris Agreement and where they are of an equivalent standard to ACCUs.<sup>11</sup>

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<sup>9</sup> Commonwealth of Australia, *2017 Review of Climate Change Policies*, 2017.

<sup>10</sup> Commonwealth of Australia, *2017 Review of Climate Change Policies*, 2017.

<sup>11</sup> Commonwealth of Australia, *2017 Review of Climate Change Policies*, 2017.

#### **4.2.2 How market customers could use offsets to reduce their emissions**

ACCUs are issued, held and transferred in the owner's account in the Australian National Registry of Emissions Units (ANREU). To use ACCUs to reduce emissions under the Guarantee, a market customer that held ACCUs would surrender them in its ANREU account. The market customer could then indicate in the ESB's proposed emissions registry the number of offsets it had surrendered. For each ACCU the market customer had surrendered, its emissions would be decreased by one tonne of carbon dioxide equivalent.

Information might need to be shared between the ANREU registry and ESB's proposed emissions registry to verify market customers' surrender of offsets.

Should the Government decide to allow the use of international units, consideration will be given to the framework for their surrender and use towards Australia's emissions reduction targets.

#### **4.2.3 What limits could apply to a market customer's offset use**

In addition to an overall cap, each market customer could have an allowance of offsets it can use in a compliance year. This could provide certainty to market customers about the extent to which they can use offsets, and would prevent the cap being exhausted by large surrenders from individual market customers.

One way to establish individual allowances would be to divide the overall cap equally between the liable market customers. This has the additional advantage of allowing smaller market customers to use offsets to cover a greater proportion of their emissions than large market customers. This could go some way to counteracting the difference in market power between small and large market customers.

Alternatively an allowance could be set based on a percentage of a market customer's load. Under a percentage-based approach, larger market customers would be able to access more offsets than smaller market customers.

The ESB is responsible for designing the flexible compliance approaches under the Guarantee, of which offsets could be one component alongside carrying forward over achievement and deferring compliance. Compliance would be monitored by the AER. There is an interrelationship between the flexible compliance options. If, for example, there are relatively large allowances for carry forward, market customers may be less likely to use offsets. As such, it is sensible that all flexible compliance options are considered together, both in the design of the Guarantee and in its ongoing operation.

The Government proposes that the process for setting individual allowances be outlined in the NEL or an instrument under the NEL. This approach was flagged in the ESB's *Draft Design Consultation Paper*. Responsibility for setting and updating allowances could rest with the market body which oversees compliance rules, either the AER or the Australian Energy Market Commission (AEMC). If offsets were included in the Guarantee, the Government could work with the relevant market body to establish market customers' initial allowances and the rules for their use. The Commonwealth Government could set principles upon which the market body could set offset allowances.

### **Issues for stakeholder consultation**

Stakeholder views are sought on:

- Whether market customers should be able to use offsets to reduce part of their emissions under the Guarantee.
- The proposed approach to using offsets to be used for compliance under the Guarantee.

## **5 NEXT STEPS**

The Government will take stakeholders' views from this consultation into consideration, and will continue to work with the ESB and the COAG Energy Council to finalise the design of the Guarantee. The ESB will present the final design of the Guarantee to the COAG Energy Council for their determination at the August 2018 meeting of the Council.

Should the Council agree to implement the Guarantee, the Government and the ESB will work together to develop and finalise draft legislation for consideration by federal and state legislatures.

## 6 ABBREVIATIONS

ACCU	Australian Carbon Credit Unit
ANREU	Australian National Registry of Emissions Units
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CER	Clean Energy Regulator
COAG	Council of Australian Governments
EITE	Emission-intensive trade-exposed
ERF	Emissions Reduction Fund
ESB	Energy Security Board
Guarantee	National Energy Guarantee
MWh	Megawatt hour
NEL	National Electricity Law
NEM	National Electricity Market
NGERS	National Greenhouse and Energy Reporting Scheme
RET	Renewable Energy Target, legislated under the <i>Renewable Energy (Electricity) Act 2000</i> (Cth)
Rules	National Electricity Rules