



**Energy Security Board
Contracts Technical Working Group**

Flexible Compliance Options – Emissions Reduction Requirement

Issues Paper

Introduction

The purpose of this issues paper is to facilitate discussions with Jurisdictions and the Technical Working Group (TWG) on the detailed design elements of the flexible compliance options. Following the SCO Reference Group and TWG meetings, a more detailed technical working paper will be developed. The technical working papers and draft final design document will be available for public consultation in mid-June.

High level design

The high-level design document set out the flexible compliance options that will be in place for the emissions reduction requirement:

- Retailers should be permitted to carry forward a limited amount of a previous year's overachievement, for use in the next compliance year.
- To ensure there is adequate flexibility for retailers while ensuring the emissions reduction trajectory is met, retailers should be allowed limited deferral of compliance.
- If the Commonwealth Government determines that certain offsets may be used for compliance, the National Electricity Law and Rules could provide details regarding the use of offsets for the emissions reduction requirement.

Detailed design elements

Input is sought on a number of elements that will add detail to the high-level design:

1. Limiting anticompetitive stockpiling of overachievement
2. Preserving the signal to invest with carry forward
3. Quantitative limits on carrying forward overachievement
4. Conditional rules for applying carry forward limits
5. Unreasonable withholding of overachievement
6. Limits on retailers deferring compliance
7. Use of offsets.

Issues for consultation

1. Limiting anticompetitive stockpiling of overachievement

The high-level design paper noted further consideration of the appropriate limit to carrying forward overachievement, if any, will be undertaken in this stage of stakeholder consultation along with any provisions necessary to prevent hoarding.

In response to ESB's February consultation paper, stakeholders generally supported the ability to carry forward overachievement – some retailers supported the ability to carry forward without limit, whereas some others supported placing limits to ensure the overachievement is made available to the market.

Limits on a retailer's ability to carry forward overachievement are intended to mitigate the potential risk of retailers stockpiling their overachievement in order to make it more expensive for other retailers to comply.

As much as practical, the design of carry forward limits should mitigate against this risk without constraining the ability of retailers to carry forward for genuine, non-anticompetitive business purposes.

Questions:

- What are the circumstances where retailers would overachieve and carry forward for genuine business purposes?
- In what circumstances should retailers not making available their overachievement to other retailers be considered anticompetitive?

2. Preserving the signal to invest with carry forward

The ability to carry forward overachievement without any limits can allow investors in new low emissions capacity to realise the full value of the emissions reduction they achieve. In the absence of any limits, retailers would continue to demand and value all the emission reductions a generator achieves, even in a year where the sector meets the emissions target, because retailers could carry their overachievement forward to any future year where the target may not be met.

Placing limits on the ability of retailers to carry forward overachievement can, but does not always, undermine the ability for investors to realise the full value of emission reductions achieved from their generators.¹

An unlimited ability to carry forward overachievement can allow a large stockpile of overachievement to be built up across all retailers, which can signal to the market that no further investment in low emissions generation is needed for some time.

The RET has allowed unlimited overachievement to be carried forward by retailers to subsequent compliance years.

Questions:

- In what circumstances can carry forward limits undermine the signal to invest?
- In what ways can the investment signal be preserved, when applying carry forward limits?

3. Quantitative limits on carrying forward overachievement

The intention of the emissions registry is that by the end of a compliance year, a retailer's allocated output should match its load. If a retailer does not comply, the registry may have a rule that any output allocated to a retailer in excess of its load by the end of a compliance period is reassigned to the residual pool (potentially prioritised according to the least emissions intensive load) or reassigned

¹ For example, the ability of an investor to realise the full value of a generator's emission reduction may not be undermined if the total overachievement of the sector is less than the sum of all retailers' carry-forward limits, because it should be able to find a retailer with the capacity to carry forward.

through another mechanism (this is discussed in the emissions registry issues paper, section 7). This could create a natural carry-forward limit for retailers because if they do not make available any low emissions generation above their load, the benefit could automatically transfer to other retailers. This option by itself won't impose any carry-forward limits for those retailers with allocated output that is not in excess of its load.

The Board is, at this stage, inclined towards a specific quantitative limit on carrying forward overachievement to be applied in proportion to the emissions target per MWh of load. For example, a limit of 10 per cent of an emissions intensity target.

The carry forward limit would be a maximum in each compliance year. There will be no specific time limit on carrying forward, however a retailer that carried forward overachievement at the quantitative limit in one year would have to use this overachievement before being allowed to carry forward further overachievement.

A retailer that went beyond the quantitative limit would lose the benefits of excess low emissions generation. In contrast to a possible requirement for any output allocated to a retailer in excess of its load to be reassigned, the benefits would not be transferred back to the unassigned pool or allocated to other retailers.

- Questions:
- At what level should the quantitative limit on carrying forward overachievement be set to effectively limit the potential risk of anticompetitive stockpiling while minimising adverse impacts on the investment signal?
 - Should this limit be set in the National Electricity Law or National Electricity Rules?

4. Conditional rules for applying carry forward limits

In some circumstances, applying limits may not be needed or helpful in addressing anticompetitive stockpiling of overachievement.

If all retailers met or overachieved the emissions target in a compliance year, then it may not be necessary to force retailers to make available their overachievement to others because all retailers should be in compliance. Allowing retailers to carry forward without limit in this situation could help preserve the investment signal, though it may create some uncertainty for retailers about whether a limit is likely to apply to their overachievement in a particular compliance year.

In some cases, retailers may have a legitimate case for not making their overachievement available to the other retailers. For example, a retailer may have a specific product offering to sell zero emissions electricity to customers (e.g. GreenPower). One way of managing this could be through carving out voluntary action obligations such that carryover limits would not apply to that portion of a retailers load (discussed in retail load issues paper).

- Questions:
- Under what conditions, if any, should the carry forward limit not apply?

5. Unreasonable withholding of overachievement

The high-level design paper set out that to ensure that a competitive market is fostered, there should also be a legal requirement that market participants not unreasonably withhold any overachievement from other market participants.

How important this requirement is will be influenced by the quantitative limits on carrying forward overachievement. With stronger quantitative limits it is less likely unreasonable withholding issues will be raised.

Questions:

- How could a legal requirement that market participants not unreasonably withhold any overachievement from other market participants be implemented? How could this requirement be enforced?

6. Limits on retailers deferring compliance

The high-level design paper noted further consideration of the appropriate limit on deferring compliance will be undertaken in this stage of stakeholder consultation.

Allowing compliance to be deferred aims to balance the need for retailer flexibility while avoiding undermining delivery of the requirements of the Guarantee or delaying necessary investment in the NEM. Several factors may need to be considered in determining what an appropriate limit is, including how much flexibility retailers require to manage forecasting errors and timing of investments and what limit may be too high and undermine delivery of the Guarantee requirements.

Limited deferral is allowed under the Large-scale Renewable Energy Target. Liable entities with a shortfall that is less than 10 per cent of their total large-scale generation certificate liability for an assessment year may carry forward that shortfall amount to the following assessment year.

Stakeholder submissions in response to the ESB's February consultation paper were largely supportive of limited levels of deferral. A number of stakeholders supported a deferral limit of 5 to 10 per cent of a retailer's load or emissions requirement. Some concerns were raised with a limit as high as 20 per cent. Some stakeholders who were concerned the emission reduction target was too low opposed deferral and other flexible compliance options. A number of stakeholders thought deferral should be for limited periods e.g. one year, or only in the first years of the scheme.

Questions:

- What factors should be considered in determining the limits on retailers for deferring compliance?
- Should all retailers be able to defer a fixed amount or should it be set proportionally to a retailer's load or emissions requirement? This could give more flexibility to smaller retailers than large ones. If so, would any provisions need to be introduced to prevent large retailers re-organising themselves as several smaller retailers in order to gain the benefit of the higher limit?
- If the limit on deferral should be a static percentage of load (rather than varying), what percentage is appropriate? That is, what percentage would provide the necessary flexibility without substantially increasing the risk that the overall emissions reduction target would not be met?
- Should deferral only be allowed to the next compliance year?
- Should other restrictions on deferral be considered (e.g. only in certain years, not when a retailer has carried forward overachievement)?
- Should this limit be set in the National Electricity Law or National Electricity Rules?

7. Use of offsets

The Commonwealth Government is considering whether retailers should be able to use external offsets as a flexible compliance option to meet the emissions reduction requirement, and whether any conditions or limits should be in place on the volume and types of offsets that can be used.

If the Commonwealth Government determines that certain offsets may be used for compliance, the National Electricity Law and Rules could provide details regarding the use of offsets for the emissions reduction requirement. In addition, if the Commonwealth Government sets an overall limit on the use of offsets by the electricity sector, the Rules may address how to allocate that limit between retailers in the NEM.

There is an interrelationship between the flexible compliance options. If a relatively large amount of compliance deferral were to be allowed then there may be less desire for the use of offsets, and vice versa.

Interdependencies with other elements of the Guarantee

- Commonwealth decisions on the use of offsets
- Emissions registry
- Compliance
- Penalties