



**Energy Security Board
Compliance and Penalties Technical Working Group**

Compliance – Emissions Reduction and Reliability Requirements

Issues Paper

Introduction

The purpose of this paper is to facilitate discussions with Jurisdictions and the Technical Working Group (TWG) on the detailed design elements for determining compliance with the Guarantee. Following the Senior Committee of Officials (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 Australian Energy Regulator (AER) will be the enforcement agency for both the emissions reduction and the reliability requirements of the Guarantee, however a detailed design for both these areas is yet to be settled. The compliance framework will therefore evolve as the design is settled. Decisions on other design elements will take into account the ability to monitor and enforce compliance. Importantly the compliance framework must be structured in a way that achieves the policy objectives of the Guarantee. It is therefore important to have a robust framework for monitoring and enforcing compliance with the Guarantee.

At a high level the key difference between the compliance obligations for these components is that the emissions requirement is an ongoing obligation whereas the reliability obligation only arises when a material gap exists and the reliability requirement is therefore triggered. A summary of each obligation is briefly outlined below.

A compliance assessment of the **emissions reduction obligation** will occur following the reporting deadline for a compliance year. Throughout the compliance period, actual generation data from AEMO, combined with an emissions intensity value based on National Greenhouse and Energy Reporting Scheme (NGERS) data from the previous year, will be provided into a registry. At the end of the compliance period, total emissions for each electricity generator will be updated to reflect more accurate figures and ensure consistency with the NGERS framework.

The design of the registry will allow retailers to have a share of a generator's combined production and associated emissions by station allocated to them, after the allocation is accepted by that generator and presented by the retailer for the purposes of compliance.

Any unallocated energy and emissions within the registry would then contribute to calculating the emissions intensity applied to any unallocated loads.

Based on information derived from this registry, the AER would then compare the average emissions intensity of the retailer against the electricity emissions target in assessing compliance.

In the event that the reliability requirement is triggered, compliance with the **reliability obligation** will only be assessed when two conditions are met; the Australian Energy Market Operator (AEMO) had to exercise its procurer of last resort function and actual system peak demand exceeds that which would be expected to occur one in every two years.

In this event, the AER will, using data from the relevant period/s, determine each liable entities' share of the actual system peak demand. The AER will then review the contract positions of all liable entities to

assess whether they had adequate enduring contracts in place to meet their share of a one in two year expected system peak demand.

TWG input is sought on whether this design element - of assessing based on the forecast system peak demand that would be expected to occur one in every two years - is appropriate.

The contract positions for each liable entity will be initially disclosed to the AER at the point AEMO begins its 'procurer of last resort' function.

Detailed design elements for TWG input

- How should the compliance framework be structured?
- What is an appropriate disclosure requirement for each obligation?
- How should the AER undertake its role?

Issues for discussion

1. How should the compliance framework be structured?

An appropriate compliance framework will be developed with reference to the following guiding principles:

1. The obligations should be fair and consistently applied to all liable entities
2. The framework should be appropriately transparent in respect to; AER activities, information requirements for liable entities and third parties, along with the AER's compliance assessments.
3. The information requirements must be standardised and appropriate to meet the compliance requirements.
4. The compliance costs should be minimised where possible

Questions for the TWG:

- Do you consider the safe harbour provisions - that is the assessment of the reliability obligation against the system peak demand that would be expected to occur one in every two years – are fair and appropriate?
- If a one in two year measure is not appropriate, what do you consider is a more appropriate compliance measure of system peak demand?
- Assuming that a one-in-two-year exceedance level for system peak demand is appropriate, should this level be based on historical or expected future peak demand? If historical, should this be over a specified time period (e.g. last 10 years) and if so what should this period be?
- With the emissions reduction requirement, should the compliance period be based on a calendar year, financial year or another time frame to appropriately provide regulatory certainty? This is discussed further below.
- With reference to the technical working group issues papers relating to other elements of the Guarantee provided and the above principles, are there other issues that require consideration when developing the compliance framework?

Previous stakeholder comments in relation to the compliance period for the emissions requirement were mixed with a split between the preference for financial years to align with NGERs, corporate reporting

and network pricing, and calendar years to align with the Renewable Energy Target compliance and emissions-intensive, trade-exposed (EITE) exemption processes.

In the case of a financial year compliance period, given the NGERs final emission intensity is not finalised until the following calendar year, a preliminary compliance assessment could be undertaken with reference to historical values and then a final assessment undertaken when the actual values are available. This could be through a true-up to manage any variance and could occur in a future compliance period. Alternatively, emissions intensity for the compliance period could be derived from actual emissions for the period, but in this case the compliance assessment would be lagged.

2. Disclosure requirements to assess compliance

Where possible the reporting requirements for both the emissions reduction and the reliability obligations should build on existing information sources. Where new information is required to assess compliance, the compliance framework will need to provide guidance on the types of information to be reported to the regulator and the form in which that information is to be reported.

For the emissions obligation, retailers will need to report on how their actual load is allocated to each generation source in the registry. Whilst the framework specifically provides for flexibility in how these allocations may be achieved, the registry reporting requirements will need to be standardised as much as possible.

Similarly, if the reliability obligation is triggered, liable entities will be required to demonstrate they had adequate enduring contracts in place to meet their share of system peak demand (including demand response) at the time of the reliability 'gap'. Whilst these contracts will vary in form they will need to be consolidated into a standardised format for the purpose of reporting.

Questions for the TWG:

- Do you consider there would be merit in a standard format that can encompass the different types of contracts and agreements that may be in place to meet the emissions reduction and the reliability obligations?
- How should the key features of the standardised format be determined?
- Do you consider that the same reporting format can be used for both the emissions reduction and the reliability obligations?

With regard to the reliability obligation, the liable entity will need to report the contracted position at the point AEMO begins its 'procurer of last resort' function. However, there may be circumstances in which the underlying contract requirements may change following this reporting deadline, for example the liable entity may unexpectedly increase their forecast demand for the relevant period due to the acquisition of a new customer.

Questions for the TWG:

- What measures do you think are required to meet this potential issue?
- Is it sufficient to provide the AER with discretion to assess these circumstances or should these circumstances be explicitly outlined in the framework?

3. AER role

For the Guarantee to achieve its policy objectives, it is important to have a robust framework for monitoring and enforcing compliance with the Guarantee. For this to occur the AER must have the appropriate powers and enforcement tools to achieve this.

The AER will assess compliance against the various obligations that arise from the emissions reduction and the reliability requirements of the Guarantee. The AER already has access to a range of compliance tools and discretion in deciding whether to take enforcement action and the nature of that action. Each case is assessed on its merits. In determining an appropriate enforcement response, the AER considers all relevant factors and circumstances.

Potential enforcement tools, based in most cases on the AER's current powers, are listed below (noting that these could apply in addition to the automatic carry-over of a retailer's under-compliance with the emissions reduction requirement in one compliance year to the next compliance year).

- Culture of compliance: Minimising non-compliance through informing, educating and engaging stakeholders is better than enforcement action after a breach has occurred. The AER should actively educate and engage with the market to ensure participants understand their obligations and encourage compliance.
- Administrative undertakings: Administrative resolutions are a more informal and less intrusive enforcement option which the AER uses to resolve certain matters. The AER may be more likely to accept an administrative undertaking where the effect of an actual or potential breach is limited, and a business has taken (or agreed to take) appropriate steps to end the conduct and to remedy any harm done.
- Infringement notices: These specify the nature of the contravention and the amount of the penalty that must be paid. The AER's current practice is to publish all infringement notices. The amount of the penalty must be sufficient to act as a deterrent.
- Enforceable undertakings: These are written statements from an entity that it will take specified actions (for example, entering into contracts in order to resolve a breach). Compliance with these undertakings can be enforced by the courts and are a valuable tool in addition or as an alternative to infringement notices.
- Institute civil proceeding: The AER can initiate civil proceedings in the courts for alleged breaches of civil penalty provisions of the national energy laws:
 - Injunctions: A court may order an injunction requiring a person to do something or desist from doing something.
 - Civil penalties: A court may order that an entity pay a financial penalty as a result of breaching its obligations.
- Suspending market participation or revoking retail authorisation: As a final step, in cases of significant and repeated non-compliance, the AER may take steps to remove the liable entities ability to participate in the National Electricity Market.

The preliminary approach at the outset should be to build a culture of compliance. Given that the Guarantee will be new to market participants, the AER will need to ensure that the appropriate information is easily available to retailers and that they understand the requirements and mechanism through which they can meet their requirements.

If however, compliance and enforcement action is required to address non-compliance, the AER must have appropriate powers and enforcement tools to ensure the policy objectives are met, and therefore the non-compliance is addressed in a timely and effective manner. Effective enforcement requires the enforcement agency to have resources to determine when an entity has not complied with its obligations, and to impose an appropriate penalty: one that is proportionate to the offence, acts as a deterrent, and provides greater certainty that the policy objectives are to be met¹.

¹ Further discussion on the penalty framework can be found in the *Penalties TWG issues paper*

As the Emissions reduction component is an ongoing compliance obligation, the AER will publish annual high-level compliance outcomes to track industry compliance. This could include, the proportion of entities covered by the Guarantee that complied with the emissions reduction requirements. In the interests of transparency and accountability there may be scope to broaden this public assessment to track more detailed compliance findings relating to each liable party.

Questions for the TWG:

- What additional powers could the AER be given to undertake compliance monitoring and enforcement action for non-compliance of these obligations? Are there particular AER compliance and enforcement tools that are more relevant in this compliance framework to achieve compliance with the emission reduction and reliability obligations?
- What information should the AER provide in the annual compliance assessment for the emissions reduction requirement?

Interdependencies with other elements of the Guarantee

The compliance and enforcement framework will evolve as the detailed design for both the emissions and the reliability components of the Guarantee are settled. The TWG are encouraged to provide any other comments as the detailed design is further developed.