

Design options for the expanded National Renewable Energy Target Scheme

Client Alert

Australia

BAKER & MCKENZIE

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Introduction

On 2 July 2008, as part of the development of an expanded national renewable energy target scheme, the Council of Australian Governments Working Group on Climate Change and Water (Working Group) published a Green Paper entitled Design Options for the Expanded National Renewable Energy Target Scheme (Green Paper).

The Green Paper sets out two design options for an expansion of the existing MRET to meet the Federal Government's commitment to increasing Australia's renewable energy capacity to 20% by 2020 as part of Australia's response to climate change. It also sets out the various issues currently being considered by the Working Group in its design and development of the NRET, and invites public submissions in response to these issues. Submissions from interested stakeholders in response to the issues and design approaches outlined in the Green Paper should be provided by 30 July 2008.

The final design of the NRET, which will reflect public submissions in response to the Green Paper, will be presented to COAG for approval in October 2008.

This client alert summarises the design issues raised in the Green Paper, and the two design approaches identified by the Working Group for an expanded national renewable energy target scheme.

1. Background

The Federal Government has committed to introducing a National Renewable Energy Target scheme (*NRET*) as a means of supporting Australia's renewable energy industry and contributing to Australia's response to climate change. The NRET will subsume existing national and state renewable energy target schemes, and ensure that at least 20% of electricity generated in Australia (approximately 60,000 gigawatt-hours) comes from renewable resources. In this way, the NRET is intended to provide interim support to Australia's renewable energy industry during the development and early operation of the Australian Emissions Trading Scheme (*AETS*) when the price of carbon is expected to be relatively low.

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2. Issues in the design of the NRET

As part of the development of NRET, the Council of Australian Governments (*COAG*) Working Group on Climate Change and Water (*Working Group*) published a Green Paper entitled Design Options for the Expanded National Renewable Energy Target Scheme (*Green Paper*) on 2 July 2008. The Green Paper sets out a number of issues to be addressed by the Working Group in its development and design of the NRET, and invites public comment on these issues. Submissions from interested stakeholders on the design approaches outlined in the Green Paper should be provided by 30 July 2008.

The issues identified in the Green Paper are:

- **liability and annual targets** – the profile of the annual targets applied in the NRET will affect the rate and extent of investment in renewable energy in Australia, by determining the levels of renewable generation that must be achieved and the dates by which these levels must be reached;
- **eligible sources** – the eligibility of sources of renewable energy under the NRET will not only determine which renewable energy sources will benefit from the NRET, but also the extent of those benefits for individual sources. A broader range of eligible sources should result in a broader distribution of the benefits of the NRET, meaning that more renewable energy technologies will be supported, but also that individual technologies may receive less support in total during the life of the scheme. Key questions here concern whether solar water heaters and particular biomass sources (native forest products) will be eligible to generate RECs under the scheme;
- **banking of Renewable Energy Certificates (RECs)** – banking of RECs under NRET would ensure a least-cost approach under the scheme, but would create the parallel risk that the amount of renewable energy capacity installed under the scheme was less than the target, or less than the amount that would be installed if banking was not permitted. Banking is permitted under the MRET and existing state renewable energy target schemes;
- **project eligibility periods** – limiting the eligibility of renewable energy projects to generate RECs under the NRET would help the NRET to provide an incentive to install new renewable energy capacity for longer, and avoid the NRET target being exhausted relatively early in the scheme's life. Such an approach would, however, limit the revenue that individual projects could generate from REC sales under the scheme;
- **existing generators** – the Green Paper distinguishes three types of renewable energy generators: those built before the introduction of MRET in 1997; those built after the introduction of MRET but before the announcement of the NRET in December 2007; and power stations eligible for support under Victoria's Renewable Energy Target scheme (*VRET*), which is to be subsumed into the NRET. Treatment of existing renewable energy generators will affect the amount of new renewable energy capacity required to meet the scheme's targets, and therefore the overall cost of the scheme;

- **duration and phase-out** – the Green Paper acknowledges that renewable energy projects will require extended REC revenue streams in order to be implemented successfully under the NRET, but also that the scheme should be phased out once the AETS has established a carbon price signal that improves the cost-competitiveness of renewable energy;
- **compliance mechanisms** – the REC shortfall charge applied in the NRET will provide an incentive to comply with the scheme (assuming it is set higher than the cost of purchasing RECs), but will also act as a cap on the maximum REC price;
- **trade-exposed electricity-intensive industries**; MRET did not include any exemptions for trade-exposed electricity-intensive industries, but the Green Paper indicates that the treatment of such industries under the NRET will be considered in the context of their treatment under the AETS.

3. Current design approaches

The Green Paper sets out two possible design approaches to the NRET currently being considered by the Working Group. These two approaches will provide the focus for modelling and analysis of the NRET and its impacts, and the objectives and distinguishing features of each are summarised below:

3.1 Approach 1 – NRET structured to achieve target at least cost

The first approach being considered by the Working Group focuses on achieving the NRET target at least cost, and incorporates the following design features to contribute to this objective:

- (a) **Longer project eligibility periods:** new renewable energy projects would be eligible under Approach 1 to generate RECs throughout the energy projects can generate from REC sales under the scheme, but potentially reduce the amount of new renewable energy capacity installed during the scheme's later stages (as early projects would continue to generate RECs that could be used to meet annual targets). Existing renewable energy generators, except those accredited under the Victorian scheme, would be eligible to generate RECs only up until the end of 2020, as the date at which REC generation under MRET was to cease.
- (b) **Inclusion of solar water heaters as eligible sources:** under Approach 1, solar water heaters would be eligible to generate a volume of RECs equivalent to an amount of renewable electricity deemed to be generated during ten years of operation, allowing part of the NRET target to be met by renewable sources that do not contribute on-grid electricity. Native forest biomass would be eligible to generate RECs as under MRET, subject to particular conditions.
- (c) **Unlimited banking of RECs:** Approach 1 would allow for unlimited banking of RECs throughout the duration of the NRET, such that RECs generated during the early stages of the scheme could be held and used to meet liabilities later in its life. Allowing banking in this way would create a strong incentive for early action in installing new renewable

energy capacity, by enabling RECs generated in excess of annual targets to be sold to liable parties for retirement in later years. Unlimited banking could, however, potentially reduce the amount of new capacity installed later in the scheme, and in total during its life, as later demand for RECs could be met using banked RECs generated during its early stages.

3.2 Approach 2 –least cost balanced against technology development and deployment

The second approach set out by the Working Group in the Green Paper seeks to balance the least cost objectives of Approach 1 against other NRET objectives, including the reduction of greenhouse gas emissions and development and deployment of new renewable energy technologies. Approach 2 incorporates the following design features:

- (a) **Extension of scheme life and targets:** the annual renewable generation targets under Approach 2 would be peak at 2020 and remain at that rapidly than under Approach 1) after 2024, subject to review of the scheme in 2015. This would maintain the targets to be met by liable entities.
- (b) **Eligibility of new projects limited to 15 years:** under Approach 2, the period during which new renewable energy projects would be eligible to generate RECs would be limited to 15 years. This limitation would ensure that the incentive to install new renewable energy capacity was maintained until relatively late in the scheme, when compared to Approach 1, but would entail higher costs in maintaining the investment needed to finance this additional capacity. As for Approach 1, existing renewable energy generators, except those accredited under the Victorian scheme, would be eligible to generate RECs only up until the end of 2020.
- (c) **Exclusion of solar water heaters after 2020:** Solar hot water heaters would be eligible to generate RECs under Approach 2 only up until 2020, after which they would become ineligible. This exclusion would increase the level of renewable electricity required to be generated in order to meet the NRET target, which would in turn drive greater installation of new renewable energy capacity than under Approach 1, although at potentially greater cost. Approach 2, like Approach 1, would recognise native forest biomass as an eligible renewable source, subject to particular conditions.
- (d) **Limited banking of RECs:** under Approach 2, only limited banking of RECs would be permitted, subject to the results of modelling and analysis. This limitation would help to ensure that the incentive to install new renewable energy capacity is maintained throughout the scheme, and therefore drive investment in new renewable energy capacity throughout its life. This increased investment would, however, necessitate higher costs for Australian electricity consumers.

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3.3 Similarities between Approach 1 and Approach 2

Notwithstanding the above differences, Approaches 1 and 2 would share the following core features:

- (a) **Accelerating increase in annual targets:** the annual targets under both Approach 1 and Approach 2, as proposed in the Green Paper, increase gradually the early stages of the scheme, in order to promote initial investment in new renewable energy capacity, and increase more rapidly during the scheme's later stages, as new technologies become more cost competitive and economies of scale are achieved.
- (b) **Limited eligibility of existing renewable energy projects:** under both Approach 1 and Approach 2, pre-1997 (MRET) and pre-2007 (VRET) existing generators would only be eligible to generate RECs up until the end of 2020, in order to avoid them obtaining windfall gains for investments made on the basis of schemes scheduled to end in 2020.
- (c) **Shortfall charge set above the projected maximum REC price:** both Approach 1 and Approach 2 include a shortfall charge for failure to submit RECs, to be set at a level higher than the projected maximum REC price, to encourage compliance throughout the duration of the scheme (meaning that the charge would not need to be indexed to the Consumer Price Index in order to remain above REC prices and encourage such compliance).
- (d) **Scheme review in 2015:** the Green Paper indicates that whichever design is ultimately adopted, the scheme will be subject to review in 2015 to determine its effectiveness and whether any refinements in the design will be necessary in order to reach the scheme target.

Following receipt of public submissions in response to the Green Paper, the Working Group will present its final design for NRET to COAG for approval. Once approved, this design will form the basis of Commonwealth legislation to implement the scheme.

For further information please contact any of our team listed on the left.

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