

Transitional arrangements for the NSW Greenhouse Gas Reduction Scheme

Consultation paper



Publisher

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*Transitional arrangements for the NSW Greenhouse Gas
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Foreword

I am pleased to release for public comment this consultation paper on transitional arrangements for the NSW Greenhouse Reduction Scheme.

The NSW Greenhouse Gas Reduction Scheme, or GGAS, is a state-based emissions trading scheme that has been operating in NSW since 1 January 2003, and in the ACT since 1 January 2005. To date GGAS has resulted in the abatement of some 60 million tonnes of greenhouse gases.

The NSW Government strongly supports the implementation of a National Emissions Trading Scheme (NETS) and has for some time been calling for a national scheme. The NSW Government has already legislated to ensure that GGAS will end when a NETS commences, and has indicated that a clear transitional process will be put in place.

This paper does not seek comment on the design of the NETS which is a matter for the Commonwealth Government in due course, in consultation with the States and Territories. This paper concerns the transition from GGAS to such a scheme.

In particular, the NSW Government is seeking input as it develops a set of high level principles to guide the transition process. As the paper indicates these include effectiveness in reducing greenhouse gas emissions, economic efficiency, fairness and regulatory certainty.

The NSW Government cannot unilaterally decide the nature of a transition plan from GGAS to the NETS. Negotiations will be required with the Commonwealth Government.

These negotiations cannot wait until the final NETS design is known because the transition plan is itself part of the final NETS design. In other words, the negotiations have to be conducted knowing that the NETS design is still being developed. This consultation process will be a key input to inform the NSW Government's position in these negotiations.

The NSW Government has established a GGAS – NETS Transition Working Group to ensure that stakeholders have an opportunity to voice their position. The Working Group includes representatives from industry, environment groups and government.

The Working Group's objective is to assist the NSW Government in developing an appropriate framework for the transition of GGAS to a NETS. However, recognising the level of interest in these issues, the Government is seeking the broadest stakeholder participation possible by calling for public submissions on this consultation paper.

The Hon Ian Macdonald MLC
Minister for Energy

Invitation to comment on Consultation Paper

The NSW Department of Water and Energy invites comments on this Consultation Paper.

Closing date for comments: 28 April 2008

Comments and inquiries should be forwarded electronically to ggastransition@dwe.nsw.gov.au, preferably in MS Word format. It would be appreciated if respondents indicated the section number to which their comments refer. Alternatively, comments on disk or in hard copy format can be posted to:

Greenhouse Gas Reduction Scheme Transition Review
Department of Water and Energy
GPO Box 3889
SYDNEY NSW 2001

This Consultation Paper is also available electronically from the Department's website at www.dwe.nsw.gov.au

Submissions will be published on the Department of Water and Energy's website unless they are marked otherwise. The Department will also be pleased to receive confidential submissions which will not be published. All submissions will be considered in developing the Government's position on a transition plan.

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1 Introduction

The Commonwealth Government intends to implement a national emissions trading scheme in 2010. Upon the commencement of that scheme, the (NSW) *Electricity Supply Act 1995* provides that the NSW Greenhouse Gas Reduction Scheme (GGAS) will cease to operate. Because the two schemes cause a price to be applied to greenhouse gas emissions associated with energy consumption, it would be confusing to have multiple price signals. The cessation of GGAS will also have the effect of avoiding duplication of obligations for industry.

Clearly a smooth transition between the two schemes is highly desirable. It is important to protect the legitimate business interests of those who have responded to the investment incentives created by GGAS as well as maintaining the environmental integrity of greenhouse policy.

This consultation paper sets out a range of issues that should be addressed in the transition plan, and raises some options for dealing with them. Stakeholder feedback is welcomed.

The NSW Government has created two consultation groups to discuss transition options:

- the GGAS-NETS Transition Working Group; and
- the Demand Side Abatement (DSA) Transition Working Group.

The DSA Transition Working Group is examining transition options specifically for the DSA elements of GGAS. It will report to both the Minister for Climate Change, Environment and Water and the GGAS-NETS Transition Working Group. The GGAS-NETS Transition Working Group will examine all remaining transition issues.

It is important to note that the NSW Government cannot unilaterally decide the nature of the transition plan. Negotiations will be required with the Commonwealth Government. This consultation exercise will be a key input to inform the NSW Government's position in those negotiations.

2 Scheme background

GGAS commenced operation in NSW on 1 January 2003, and was one of the first mandatory emissions trading schemes in the world. The ACT joined the scheme in 2005. GGAS is underpinned by provisions in the *Electricity Supply Act 1995* (NSW).

The scheme requires liable parties to purchase abatement certificates to reduce the imputed emissions associated with the electricity that they sell or use. Liable parties under the scheme are principally electricity retailers, but also include some generators and large electricity consumers.

Abatement certificates can come from four sources. Eligible abatement is defined in the Rule governing each activity:

- electricity generation (Generation Rule);
- energy efficiency measures (DSA Rule);
- forestry-based carbon sequestration (Sequestration Rule); and
- large user abatement activities, which can be other types of abatement not directly related to electricity production or consumption (Large User Abatement Rule).

GGAS is a baseline and credit emissions trading scheme. Each abatement certificate represents one tonne of carbon dioxide equivalent (CO₂-e) that has been abated – that is, a reduction in emissions, measured against a baseline.

The NETS will be a cap and trade scheme. Traded certificates will be permits to emit one tonne of CO₂-e. Offset credits, including from forestry sequestration, will be an exception, representing one tonne of CO₂-e removed from the atmosphere.

GGAS and the NETS will not operate in parallel. In November 2006 the *Electricity Supply Act 1995* was amended such that GGAS may be terminated if NSW participates in a NETS that will achieve greenhouse outcomes at least as stringent as GGAS.

The two schemes both seek to reduce emissions, in different ways. These different ways of creating incentives for abatement activities, the national scope of the NETS, and the possibility of different targets, mean that smooth transitional arrangements will not occur automatically, and must be planned.

3 Objectives for a transition plan

In releasing the NSW Greenhouse Plan in November 2006, the Premier committed the NSW Government to meeting greenhouse targets of:

- a 60 per cent cut in greenhouse emissions by 2050; and
- cutting greenhouse emissions to year 2000 levels by 2025.

GGAS has been one of the important measures in the putting the electricity sector on the path to contribute to meeting these targets. The objectives of GGAS are to reduce greenhouse gas emissions associated with the production and use of electricity and to encourage participation in activities to offset the production of greenhouse gas emissions. GGAS allows trade in NSW Greenhouse Abatement Certificates (NGACs).

Similarly, the objective of a NETS will be to deliver sustained, long-term greenhouse gas reductions while minimising the overall cost to the economy.

The design of the transition plan must be guided by the objectives of GGAS and NETS while maintaining regulatory certainty and confidence in carbon markets.

The proposed objectives of the transition plan are:

- **effectiveness** in reducing greenhouse gas emissions by maintaining:
 - maximum consistency with the objectives and key design features of both GGAS and the NETS;
 - incentives to comply with GGAS obligations prior to NETS commencement; and
 - incentives to pursue greenhouse reduction projects to the same extent during the transition phase and in the early years of the NETS;
- **efficiency**, by ensuring that the transitional arrangements do not detract from the overall economic efficiency of GGAS and the NETS, in particular to effect abatement at minimum cost;
- **fairness** by ensuring that investments made viable as a result of GGAS are not rendered uneconomic by the termination of GGAS and its replacement with a NETS; and
- **regulatory certainty and confidence in carbon markets** by minimising avoidable impacts of the transitional arrangements and the termination of GGAS on both the NGAC and NETS permit markets.

4 Transitional issues and options

There are several issues that should be addressed in the transition plan. These include:

- the transition timeframe;
- how accredited abatement certificate providers are to be treated, including:
 - generators creating certificates from fossil fuel generation under the Generation Rule;
 - generators creating certificates from burning landfill gas or other waste gases;
 - Category A generators and deemed retailers;
 - forestry sequestration providers;
 - firms undertaking large user abatement activities;
- what happens to unused NGACs and Large User Abatement Certificates (LUACs) when GGAS ceases to operate; and
- how new abatement certificate providers are to be treated in the transitional arrangements.

4.1 Transitional timeframe

The appropriate timeframe for considering transitional arrangements is guided by investors' reasonable expectations about the period over which they could earn revenue from NGACs. Several factors need to be considered in determining reasonable expectations:

1. When the GGAS legislation was first passed in 2002, greenhouse targets were only set until 2012.
2. When GGAS was extended in 2006, it was clearly communicated that the scheme would cease in the event of a national emissions trading scheme coming in to effect.
3. In February 2007, the State and Territory Governments publicly stated that if the Commonwealth Government refused to commit to the introduction of a NETS then "the States and Territories will introduce an emissions trading scheme by the end of 2010".
4. The former Prime Minister announced on 3 June 2007 that the Commonwealth Government would implement a NETS by 2012.

Taking these factors into account, investors would only have formed a reasonable expectation of earning NGAC revenues until 2012. Once GGAS was extended beyond 2012, it was on the clear understanding that GGAS would cease in the event that a national emissions trading scheme commenced.

For these reasons, this consultation paper discusses transitional arrangements for the period from NETS commencement in 2010 to the end of 2012.

There may however be projects that were commenced or committed in the period between the extension of GGAS and the announcement of a commitment to implement a NETS. For these projects there may be an expectation of a benefit until 2020 or beyond, or that the investment would be no worse off under a NETS than it would have been under GGAS.

There may also be issues with forestry-based carbon sequestration where the initial action (planting) enables the production of credits over a long time period (e.g., 100 years). Some consideration of carrying over accreditation of these projects into a national emissions trading scheme will be important.

Comment is sought on the view that transitional arrangements should only apply to the period from the commencement of the NETS to the end of 2012 in most instances. Where it can be demonstrated that investments were made after GGAS had been extended and before the Commonwealth Government had committed to a NETS, how should they be treated?

4.2 Treatment of accredited abatement certificate providers

As noted above, there are four Rules under which abatement certificates may be created. Some rules, particularly the Generation Rule, contain multiple categories of abatement creating activities.

The range of activities covered by the GGAS scheme presents transitional challenges. Appropriate ways of dealing with each type of abatement certificate provider will depend on several factors, including whether:

- the provider will become a liable party under the NETS (or will face higher energy prices as a result of NETS);
- the emissions being abated will be covered (capped) under the NETS, or alternatively could be reduced and counted as an offset credit; or
- the provider might otherwise be eligible for an allocation of permits unless there is full auctioning of permits.

Different categories of abatement activities are discussed below, with suggested transitional arrangements. Comment is sought on these options.

4.2.1 Fossil-fuel generators (excluding waste coal-mine gas generators and Category A generators)

There are three main ways in which NGACs can be created from electricity generation:

- generating electricity from power stations with a lower emissions intensity than the NSW Pool Coefficient;
- reducing the emissions intensity of a generator; or
- cogeneration (either classified as Demand Side Abatement or Generation, depending on whether the output of the generator is used on-site or exported.)

Category A generation, generation from waste coal mine methane and cogeneration are discussed separately below.

Effects of the NETS on generation abatement projects

Generation from relatively low emissions plant, improving the emissions intensity of a plant, and cogeneration are all activities that will be implicitly rewarded under the NETS. The NETS will change the competitive position of generators in much the same way as GGAS does at present – although through a different mechanism. GGAS operates to reward less emissions-intensive generation, whereas a cap and trade scheme penalises more emissions-intensive generation.

Whether the benefits created by the NETS for these generation abatement projects are as large as those currently being created by GGAS depends on a number of factors, the main two being:

- the price of NGACs compared with the price of NETS permits (which is, in turn, a function of the relative stringencies of the two schemes amongst other things); and
- wholesale electricity prices under GGAS compared with wholesale prices under the NETS.

It is possible that due to the design of the NETS generators that have undertaken abatement projects could be better off, worse off, or equally well off under the NETS compared with GGAS.

Possible transition option for discussion

Both the Prime Minister's Task Group on Emissions Trading (PMTG) and the State and Territory based National Emissions Trading Taskforce (NETT) have proposed a once-off, up-front allocation of free permits to those generators that would otherwise experience a 'disproportionate loss of value' by the introduction of the NETS. The NETT and the PMTG Report proposed estimating the reduction in operating profits that would be experienced by the generator, on a plant-by-plant basis.

If the Commonwealth Government proceeds with allocation of permits in this way, a possible transition option is that when making the calculations of 'disproportionate loss of value', revenue from NGAC creation could be taken into account. That is, the regulator would be required to estimate the plant's operating profits for a 20 year period in the absence of the NETS (but with GGAS until the end of 2012), and then the change in operating profits for that same period with the NETS (and no GGAS).

If the plant's operating profits are found to be disproportionately affected, a stream of permits with the same net present value (NPV) as the NPV of the stream of reductions in operating profits – minus an adjustment for 'proportionate' loss – could be made.

It is possible that some generators that are currently NGAC creators would be better off with the NETS, despite the fact that they can no longer create NGACs. In such cases, no free permits would be issued.

The disadvantage of this approach is that it is dependent on a number of assumptions and estimations, including future NGAC prices, permit prices, and electricity prices.. However, all measures that attempt to compensate for lost value require consideration of uncertain future values.

The advantage of the approach is that it directly addresses the issue of the impact on the investor.

Providing that the permits that are allocated to generators through this approach come out of the existing cap, and are not additional to it, the impact on the environmental integrity of the NETS should not be diminished.

This approach does not appear to risk distortions to the existing NGAC market, or diminish incentives for GGAS compliance in the interim period.

If the decision is made to auction all permits (except for trade exposed emissions intensive industries), then a possible transition option is for some of that auction revenue to be provided to redress the disproportionate loss of value of abatement certificate providers under GGAS.

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| Do you support either of these options? If these options are not supported, are there other options that stakeholders wish to propose? |
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4.2.2 Waste coal mine methane generators and landfill gas (or other waste methane)

GGAS currently rewards generation using waste coal mine methane or landfill gas (or other waste methane) for two things:

- displacing pool generation with gas-fired generation; and
- destroying methane that would otherwise have been vented to the atmosphere.

The treatment of these fuels under the NETS is not yet certain.

It seems likely that underground coal mines will be liable for emissions of fugitive coal mine methane. If coal mine methane is covered under the NETS, then coal mines retain good incentives to at least flare methane emissions and substantially reduce their greenhouse emissions.

Coal mines may also pursue the option of using the methane as a fuel source for electricity generation if the wholesale electricity price is sufficient under a NETS. The incentive is provided by the fact that the liability for emitting carbon dioxide from the generator will be lower than the liability for emitting methane from the mine. It is anticipated that a commercial arrangement would be negotiated between the coal mine operator and the generator.

The status of landfill and other putrescibles waste is yet to be determined. The Commonwealth Government has expressed doubts about whether there is sufficient capacity to accurately measure or estimate waste emissions to include them in the NETS at the outset.

If waste emissions are covered by the NETS, then the incentives to pursue projects such as landfill gas generation would be the same as for waste coal mine methane generation (except, as a renewable fuel, landfill gas generation would count as a zero emissions generator). The landfill operator would have an incentive to reduce methane emissions, and therefore reduce its liability, by generating electricity with this fuel. It would also benefit from the higher energy prices expected due to the NETS.

If such emissions are not covered by the scheme, then the financial incentive to pursue the project is diminished. All renewable generation will be encouraged by the fact that competing fossil-fuel generation will become more expensive under the NETS. However, this would not provide an extra reward for destroying methane. This would only occur if the project were eligible to create offset credits under the NETS.

Possible transition option for discussion

The possible transitional approaches depend on whether the fuel used in the generator would otherwise have been covered under the NETS.

If the fuel would otherwise have been a covered source of emissions, then the transitional approach could be the same as for other generators, as discussed in section 4.2.1 above. That is, an assessment could be made on whether the transition to the NETS would leave the generator disproportionately disadvantaged.

If the fuel is not a covered under the emissions trading scheme, then an additional transition option is available - continued treatment as an offset under the NETS until 2012.

The offset rules under the NETS would most likely preclude existing GGAS projects from being eligible, since they commenced before 3 June 2007. However, one transition option is for an exception to be made to allow existing GGAS projects to continue to create offset credits using their GGAS baseline until the end of 2012. At this point, they would be free to re-apply for accreditation as an offset provider, if they met the new eligibility criteria.

The advantage of this approach is that it is relatively simple. From the investors' perspective, it replaces a per-tonne stream of NGAC revenue with a per-tonne stream of NETS offset revenue.

From an environmental perspective, so long as the extra supply of offset credits is taken into account when setting the cap (that is, the cap is slightly lower than it would otherwise have been), then there is no environmental disadvantage.

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| Are these transition options supported? If not, are there other options that stakeholders wish to propose? |
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4.2.3 Category A generation

In certain cases, GGAS allocates the right to create abatement certificates to a party other than the owner of the generator. These cases mostly involve electricity retailers who have both a liability under GGAS and had a Power Purchase Agreement (PPA) with a low-emission generator in the National Electricity Market. The retailers and the generators are called 'deemed retailers' and 'Category A generators' respectively. Category A generation recognises activities that were brought to account under the voluntary "Retailer Benchmarks Scheme" that preceded GGAS in NSW.

Category A generation represents an exception to two general rules:

- output from generators that had commenced commercial operation before 1997 is rewarded; and
- it is the retailer with which the generator has a contract, rather than the generator, that it entitled to create NGACs (in most cases).

The GGAS rules allowed deemed retailers to create NGACs from Category A generation as a reward for early action. Deemed retailers are those that entered into contracts with low emission generators before 2003, and claimed that generation as part of their compliance with the original greenhouse benchmarks scheme that was in operation between 1997 and 2002.

In some cases, Category A generators themselves are entitled to create NGACs. This can occur when the generator produces more electricity than its baseline, and where it has not created renewable energy certificates (RECs) for the same generation.

Issues

The PPAs that give rise to the deemed retailer status were all entered into before 2003. The investments in these generation projects were not induced by GGAS, although they may have been induced by the former benchmarks scheme.

Deemed retailers had a reasonable expectation that they could continue to generate NGACs until 2012. This would allow them to avoid paying for NGACs for their own liabilities, and/or sell excess NGACs to third parties.

Whether or not deemed retailers will be worse off upon the cessation of GGAS and its replacement by the NETS depends on what happens to the value of the PPAs. The value of these PPAs will increase upon the introduction of the NETS. The NETS will increase the cost of more emissions-intensive supply options, improving the competitiveness of the pre-existing PPAs.

To date, no Category A generators have created any NGACs in their own right, and so no transitional arrangements would be required.

Possible transition option for discussion

If transitional arrangements are required, then the likely net financial impact on deemed retailers would need to be estimated. This would take into account the benefit of the increased value of the PPA, as well as the inability to create and use or sell NGACs.

Comment is sought on this transitional approach. Are there other options that stakeholders wish to propose?

4.2.4 Carbon sequestration projects

Transition arrangements are particularly important for forestry-based carbon sequestration as the generation of credits may not occur for a number of years after the action is first taken and would continue for, potentially, many decades afterwards.

Under GGAS, forest carbon sequestration projects can create credits under the Carbon Sequestration Rule. This rule grants credit for the estimated net increase in carbon stored in the forest in each year.

Forestry offset credits are likely to be a feature of the NETS. The Commonwealth Government has indicated that it would base its offset credit regime, in the interim period, on the existing Greenhouse Friendly scheme. The Commonwealth has further indicated its intention to review the rules for forest offsets to develop longer term arrangements. As such it is yet to be determined what type of forest offset rules will apply in a NETS. This scheme also gives credit for annual net increases in carbon stocks. However, there are several issues that may need to be considered in the transition from GGAS, including;

- *Additionality requirements:* There is no financial additionality test for forestry projects under GGAS, while there is currently a financial additionality test in Greenhouse Friendly. It is yet to be determined whether a new NETS will include a financial additionality test. If it does this may present a major impediment to the transfer of accredited GGAS forestry-based carbon sequestration into the NETS.
- *Institutional arrangements:* under GGAS, rights to create NGACs, the powers of the Scheme Administrator, penalties for non-compliance, requirements to make good failed abatement, and a potential requirement to tender 'financial assurances' in order to meet a make good provision are all enshrined in legislation and regulation. By contrast, there is currently no legislative underpinnings to Greenhouse Friendly as it was designed as a voluntary scheme – obligations are enshrined in Deeds. The Regulations underpinning offsets under the NETS have not yet been determined;
- *Permanence requirements:* GGAS requires carbon stocks to be maintained for 100 years; Greenhouse Friendly requires 70 years;
- *Uncertainty treatment:* carbon stocks are necessarily estimated from samples, rather than measured. Given attendant risks associated with sampling techniques, GGAS requires that there must be at least a 70% chance that the claimed carbon is actually in the stock. Greenhouse Friendly does not currently have a specific requirement besides requiring that estimates of carbon stocks "should be conservative";
- *Liability rules:* in the event a shortfall or reversal in sequestration, the seller of the NGAC is liable to make good this abatement under GGAS. Under Greenhouse Friendly, liability can be transferred to either party under contract. Liability arrangements under a NETS are yet to be determined; and
- *Reaccreditation:* Forest offset project accumulate carbon credits over a period of many years. The transition to a NETS and the rules of a NETS will need to consider action taken by participants in GGAS who reasonably expected to be able to generate credits for the life of the forest project.

Possible transition option for discussion

One option for transfer arrangements is to:

- transfer existing accreditations under GGAS to accreditation as an offset provider under the NETS; and
- transfer responsibility for monitoring accreditation conditions to the NETS administrator, including those that apply to NGACs already created.

It is possible that the Commonwealth Government would not agree to an unlimited transfer of accreditation for existing projects. In this case, a transition option could be to allow the creation of offset credits under Commonwealth's offsets regime until the end of 2012, at which point the provider would need to re-apply for accreditation under the normal NETS eligibility criteria.

This transitional approach would essentially be a 'tonne for tonne' approach, whereas most compensation proposals for generators are implicitly on a net financial impact basis.

Both Commonwealth and NSW legislation is likely to be required to give effect to a transfer of regulatory responsibility for existing accreditations. The main responsibilities are to:

- monitor the carbon stocks of accredited abatement certificate providers, to ensure that they are maintained for 100 years;
- ensure that no double-counting of carbon stocks is occurring (that is, ensuring that sequestration registered as an NGAC is not also registered as abatement under some other scheme);
- enforce penalties in the event that it is demonstrated that abatement certificates have been improperly created; and
- enforce make-good provisions in the event that they are triggered by either an improper creation of certificates or failure to maintain the carbon stocks for 100 years.

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| Stakeholder comment is sought on these transfer options. Are there other options that stakeholders wish to propose? |
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4.2.5 Large user abatement certificates

The Large User Abatement Rule allows large electricity consumers that are managing their own benchmark under GGAS (that is, they have elected to be liable parties in their own right) to be rewarded for non-electricity related abatement activities.

To date, activities that have led to the creation of LUACs include improvements in gas fuel use efficiency, switching to less emissions-intensive fuels, reductions in industrial process emissions, and flaring of fugitive emissions.

Many of the companies that have become Large Users under GGAS are from trade exposed energy intensive industries. It is possible that there will be some accommodation under a NETS for the fact that their international competitors will not immediately face the same level of greenhouse obligations. It is possible, subject to the detailed design of the NETS, that they may have no nett cost, relative to the balance of the economy, from the introduction of a NETS.

It is possible that some creators of LUACs may not be disadvantaged by the termination of GGAS because:

- LUACs could never be sold to third parties – they could only ever be used against their own liabilities. So, accredited LUAC creators will be denied an opportunity to create LUACs, but at the same time, they would be relieved of the corresponding liability; and
- To the extent that the abatement of emissions from the LUAC activity will be covered under the NETS, then the abatement project will reduce their NETS liabilities.

Comment is sought on whether LUAC providers are likely to be disadvantaged by the transition to the NETS, given that LUACs are non-transferable, and could only be used to offset a GGAS liability.

Possible transition option for discussion

If it could be demonstrated that an accredited LUAC provider was likely to be disadvantaged by the introduction of the NETS, then transition options could include:

- Providing free permits up to the value of the estimate of disadvantage over the transition period (to the end of 2012), less an adjustment for 'proportionate loss', in the same manner as for generators; or
- In the event that the activity leading to the creation of LUACs will not be a covered activity under the NETS, then potentially being able to create offset credits under the NETS using existing NGAC baselines until the end of 2012.

Comment is sought on these transitional options. Are there other options that stakeholders wish to propose?

4.2.6 DSA abatement certificates

Demand Side Abatement (DSA) is one of several categories of eligible abatement under GGAS and its application is governed by the Greenhouse Gas Benchmark Rule (Demand Side Abatement) No. 3 of 2003 (the DSA Rule). The DSA Rule provides specific arrangements for the creation of NSW Greenhouse Abatement Certificates (NGACs) where greenhouse gas emissions are reduced through increased efficiency of electricity use and other means of reducing the use of grid electricity without reducing production or service levels. There are four broad means of creating NGACs under the DSA Rule:

- the Project Impact Assessment (PIA) Method where the characteristics of a specific project are evaluated, where there is no impact elsewhere in the plant;
- the Metered Baseline Method where changes in energy consumption are measured against the overall plant energy consumption prior to undertaking an energy efficiency measure;
- the Default Abatement Factor (DAF) Method where the DSA Rule prescribes the abatement associated with standard activities (such as replacing an incandescent lamp with a compact fluorescent lamp). Importantly, the DAF method deems the lifetime greenhouse abatement of the activity to have occurred, and hence be credited, at the time of installation; and
- the Generation Emissions Method where an on-site electricity generator is installed to reduce the use of grid electricity, taking into account on-site emissions.

In developing GGAS it was recognised that providing credit for energy efficiency under the DSA Rule would potentially double count the greenhouse benefits of these activities. Accordingly, under clause 9.2 of the Greenhouse Gas Benchmark Rule (Compliance) No. 1 of 2003 the Total State Electricity Demand for a year is calculated by adding to the TransGrid forecast for NSW demand in that year, the electricity sales corresponding to the total number of NGACs created under the DSA Rule for the year two years before. The two year lag is necessary because final DSA NGACs are not known until the end of June for the year after the abatement was deemed to have occurred.

It seems clear that DSA or energy efficiency projects will not be eligible to create offset credits under the NETS because of the double-counting issue raised above. Such projects will benefit to an extent from the increase in electricity prices arising from the NETS.

The Premier has announced that the NSW Government will implement an Energy Efficiency Strategy. This includes support for a national energy efficiency trading scheme.

As mentioned previously, the DSA Transition Working Group is examining transition options specifically for the DSA elements of GGAS. The DSA Transition Working Group has contacted all accredited DSA certificate providers and all applicants for accreditation under the DSA Rule and sought views on the impact of the cessation of GGAS. Should stakeholders wish to provide comments on DSA activities arising from the closure of GGAS, these should be provided to the DSA Transition Working Group and will form part of the consideration of that group in providing its advice on DSA transition issues.

Comment is sought through this process on options to effectively deal with DSA projects in the transition to a NETS.

4.3 Unused Abatement Certificates

When GGAS ceases to be in force, a number of parties might be left holding unused NGACs and LUACs.

Appropriate treatment of unused certificates is important to maintain investor confidence in the remaining years of the scheme.

However, it will be important that transitional arrangements for unused NGACs do not create incentives to:

- create more NGACs than would otherwise have been supplied up to the start of the NETS, in order to take advantage of transition options;
- hold NGACs and restrict their supply to liable parties in the lead-up to the NETS; or
- for liable parties under GGAS to hold NGACs and fail to comply with GGAS, choosing instead to pay the GGAS penalty.

Possible transition option for discussion

One transitional option is to swap unused NGACs into NETS permits on a tonne-for-tonne basis at the start of the NETS. So long as these NETS permits come from the existing cap, there would be no environmental disadvantage from this approach.

However, the price of NGACs has been affected by the uncertainty surrounding the future of GGAS while the price of NETS permits in the early stages of NETS could be quite volatile due to thin liquidity and/or the market settling down. Consequently, it could be more administratively simple (while not as economically rigorous) to provide

for existing/new NGACs to be treated as offset credits under NETS until 2012, with these credits being taken into account in setting the annual caps.

This option may be particularly applicable to forest carbon sequestration projects as they will be treated as offset projects outside the covered sector of NETS. In the case of LUACs, offset credits could not be traded but only used to offset the creator's NETS liabilities. However, as they will be included in the covered sectors under NETS, their inclusion as offsets would lead to double-counting.

If there is likely to be a very large divergence between the value of NGACs at the start of the scheme and the value of NETS permits, then a tonne-for-tonne conversion may prove overly generous. In this case, incentives for banking and non-compliance would be magnified. If this appears likely, then an option of a conversion based on the estimated values of the two types of certificates could be undertaken. Conversions on the basis of value would be more consistent with the proposed approach to transition for parties accredited under the Generation Rule.

The final number of unused NGACs would depend on which future projects and current applications for GGAS accreditation actually proceed and whether any further amendments to the Rules would have the effect of limiting supply.

Are either of these transition options supported? If not, are there other options that stakeholders wish to propose?

4.4 New accreditations

The need for transitional arrangements to protect the value of investments made under GGAS applies most forcefully to parties that have already been accredited. As noted above, these parties had a reasonable expectation that they could earn NGAC revenue until 2012.

The same rationale does not apply to those who have yet to be accredited under GGAS. Such parties will know that GGAS is to cease upon the commencement of the NETS.

Transition options for discussion

A transitional option is to:

- Allow application for accreditation to proceed as normal until the end of the Scheme; and
- set a cut-off date for transitional assistance, such as those that lodged applications for accreditation on or before 1 September 2008, after which no transitional assistance would apply.

After the cut-off date, the incentive to invest in abatement projects will remain, with project proponents knowing that they can earn NGAC revenue until the end of GGAS and will have a lower exposure to NETS permit costs after that.

There may however be instances where infrastructure is in place and funds are committed before the application for accreditation of a project is lodged. Where such cases can be clearly demonstrated, they may need to be considered in the transition process

Are either of these options supported? If not, are there other options that stakeholders wish to propose?

4.5 Ending of liability under the GGAS

Provision has been made under Clause 97KB of the *Electricity Supply Act 1995* for the Governor, by proclamation published in the NSW Government Gazette, to terminate the operation of all or part of GGAS from no earlier than the day on which NSW becomes a participant in a national emissions trading scheme.

The legislation provides for the making of Regulations to address matters relating to the termination of GGAS, including such issues as the ending of retailer and Large User liability under GGAS.

Comment is sought on any issues arising from the ending of GGAS liabilities.

4.6 Other issues

There may be other issues relevant to the transition of GGAS to a national scheme that stakeholders wish to raise, and the Government would be pleased to learn of these.

Comment is sought on any other issues.

5 Next steps

Comments are sought on the transitional options canvassed in this consultation paper.

After a period of consultation, the NSW Government will commence discussions with the Commonwealth Government, with a view to agreeing appropriate transitional approaches. It is possible that further consultation with both the GGAS-NETS Transition Working Group and the DSA Transition Working Group will be required during this process.