



Climate Change Alert August 2008

What does the Green Paper mean for the Mandatory Renewable Energy Target (MRET)?

“ The Federal Government has committed to significantly increasing Australia’s Mandatory Renewable Energy Target to 20% by 2020 and is proposing that the expanded target will act in conjunction with the Carbon Pollution Reduction Scheme. However, there is concern as to how the two schemes will interact in the market and what this will mean for electricity prices. ”

What is the Mandatory Renewable Energy Target (MRET)?

The Mandatory Renewable Energy Target (**MRET**) is designed to encourage the additional generation of electricity from renewable energy sources. The current target is 9,500 gigawatt hours (**GWh**) of extra renewable energy per year by 2010 (above 1997 levels).

The MRET scheme works by imposing a liability on wholesale purchasers of electricity (retailers and large users) to purchase a specified proportion of their energy from accredited renewable energy sources. Liable parties must acquire and surrender renewable energy certificates (**RECs**) to demonstrate their compliance with the scheme. Each REC is equivalent to 1 megawatt hour (**MWh**) of electricity generation. The value of a REC is equal to the difference between the cost of producing the renewable energy and the average wholesale price of electricity. Liable parties who fail to surrender enough RECs to meet the target must pay a shortfall charge of \$40 per MWh.

The scheme is implemented by the *Renewable Energy (Electricity) Act 2000* and administered by the Office of the Renewable Energy Regulator.

What forms of energy fall under the MRET?

Eligible renewable energy sources include hydro, wind, solar, tidal, geothermal aquifers, hot rocks and landfill gas. The scheme does not apply to nuclear power or other low-emissions technologies which do not generate energy such as carbon capture and storage (**CCS**).

The Proposed Expansion of the MRET

In 2007, the Federal Government committed to a new renewable energy target (**RET**) of 20% by 2020. This equates to an extra 45,000 GWh of renewable energy generation per year (together with 15,000 GWh of existing renewable energy capacity) by the year 2020. The Council of Australian Governments (**COAG**) has released a paper on design options for the expanded RET scheme which can be accessed at www.climatechange.gov.au.

Interaction between MRET and CPRS

The Federal Government is proposing that the expanded RET target will operate alongside its Carbon Pollution Reduction Scheme (**CPRS**). A key issue of concern for stakeholders is the interaction between the two schemes and the effect this will have on electricity prices.



Renewable energy is more expensive than coal-fired electricity. The objective of the MRET scheme is to encourage investment in renewable energy despite the cost, on the basis that economies of scale and technological breakthroughs will eventually bring the cost down. In contrast, the objective of the CPRS is to reduce Australia's greenhouse gas emissions at the least cost to the economy (and will probably encourage some investment in renewable energy as a result). These two policy instruments have the potential to create confusion in the energy and investment market place. The remainder of this Alert explores these points of difference.

Arguments in favour of the MRET and CPRS co-existing

- > The CPRS should encourage greater investment in the renewable energy sector. However, a relatively high carbon price (such as \$40/tCO₂-e) will be required for renewable energy to become cost competitive with coal-fired energy. An expanded RET of 20% will encourage early investment in renewable energy while the carbon trading scheme is still developing.
- > Australia's main renewable energy source is currently wind, but other base-load renewable energy sources must be adopted if Australia is to wean itself off a coal-based electricity diet. Development of these technologies has a long lead-in time which means early investment is to be encouraged.
- > Without an expanded RET scheme, Australia may be unable to meet its greenhouse gas reduction target of 60% by 2050. This is because the CPRS will not adequately incentivise

the early investment in the necessary technologies. An expanded target provides industries with an ongoing price incentive to invest in renewable energy sooner rather than later.

Arguments against the MRET and CPRS co-existing

- > An expanded RET will not achieve any additional abatement over and above that likely to be achieved by the CPRS on its own but will impose higher administration costs and result in increased electricity prices.
- > The objective of all emissions reduction policies should be least-cost abatement. Mandating a RET will encourage investment in higher-cost zero-emissions technologies at the expense of investment in lower-cost low-emissions technologies.
- > An expanded RET may impede innovation in areas that do not satisfy the scheme's eligibility criteria. It may also provide a signal that lobbying Government for support for certain technologies over others will be successful.
- > A poorly designed RET scheme will give an unfair competitive advantage to mature (and hence least cost) renewable energy sources such as wind and will not encourage investment in new base-load but financially riskier renewable energy technologies such as tidal and geothermal.
- > Rather than introducing an expanded RET, the Government should instead encourage and invest in novel R&D activities in order to overcome industry's "early-mover" concerns about technology spillovers.

Stakeholder Positions

- > **Professor Garnaut** has recommended that the MRET be phased out as quickly as possible once the CPRS is operational, on the basis that it is likely to distort the effect of the CPRS resulting in unnecessary electricity price increases.
- > The **Productivity Commission** has submitted that the concurrent operation of the two schemes will not result in any additional emissions abatement but will result in significant additional administration and monitoring costs. It says that the Government should not pursue "market-distorting" measures such as the expanded RET and should instead rely on the CPRS as the means to achieve lower emissions.
- > Whilst accepting that the MRET may make electricity more expensive than it would otherwise be, **green groups** such as WWF argue that an expanded RET scheme is necessary in order for the Government to meet its emissions reduction target of 60% by 2050. WWF also warns against relying too heavily on wind power because it will never be able to provide sufficient base-load energy to meet Australia's needs and says the expanded RET scheme must be designed in such a way as to facilitate the development of newer technologies such as geothermal energy.
- > The **Federal Opposition** is in favour of the expanded RET of 20% by 2020 but says that the scheme should also apply to clean-coal technologies such as CCS.



- > The **renewable energy sector** is in favour of the MRET scheme being extended and expanded to ensure investment certainty until the carbon price reaches a level where renewable energy is competitive with coal power.
- > **Trade-exposed emissions-intensive industries** argue that they should be buffered from the effects of an expanded RET scheme in the same way that they will be buffered from the effects of the CPRS in order to avoid adverse impacts on their competitiveness.

Next Steps

- > The Garnaut Climate Change Review will release a Final Report by 30 September 2008 and the Australian Treasury will release economic modelling of the financial effects of unmitigated and mitigated climate change in October 2008. Both of these documents will provide further guidance as to the effect the expanded RET is likely to have on the permit price under the CPRS.

- > Start-up renewable energy companies in particular should be analysing at what permit price their operations will become cost-competitive with traditional energy sources such as coal and gas.

The Federal Government has called for submissions on the Green Paper by 10 September 2010.

If you would like to make a submission about the interaction between these two schemes, or any other aspect of the Green Paper, please contact one of the people below.

For more information on this topic please contact:



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