



A proposal to incorporate formal independent review into the NSW Electricity Supply Amendment (Greenhouse Gas Emission Reduction) bill 2002

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Introductory comments

The *NSW Electricity Supply Amendment (Greenhouse Gas Emission Reduction) bill 2002* seeks to reform a greenhouse benchmarks scheme legislated in 1995, and operated from 1997 to 2001. In general the benchmark scheme failed to meet its set objectives². The NSW Government announced a proposal to reform the scheme in December 2001, and subsequently released a series of discussion papers and draft methodologies for its implementation. The Electricity Restructuring Group at the UNSW reviewed these papers as they were released - examining both the overall policy direction of the proposed scheme, and the detail of the draft regulations. We have prepared a number of papers outlining in detail our significant concerns with the scheme as proposed, and these are available on our website www.ergo.ee.unsw.edu.au.

To summarise the findings of those papers, the proposed scheme lacks precision of definition, is open to various forms of “double counting” and makes questionable assumptions about what “Business as Usual” means into the future. Many of the issues are not contained in the enabling legislation, but reside in the proposed regulation.

These arise from key design problems with the scheme, and in particular the nature of the tradable instrument chosen for implementation (a “baseline and credit” approach), with the intrinsic problems of baseline definition that this implies³.

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² The performance of the original scheme is discussed in both the IPART Compliance Reports and the NSW EPA Audit of Effectiveness.

³ The AGO paper “National Emissions Trading – designing the market” summarises some of the potential problems with ‘baseline and credit’ schemes.

It is also appears that the NSW Government has given little consideration to the market structure in which this instrument will trade. It is as if the assumption has been made that if an instrument is provided, then efficient trading must result. This has been shown in a series of other markets – both other environmental markets and in the more traditional financial markets – to simply not be the case. The particular problems in creating efficient and effective markets that also result in genuinely achieving the policy target using ‘baseline and credit’ based instruments have been widely noted.⁴

In our opinion is it highly uncertain that genuine investment in abatement activities (such as low emission generation, energy efficiency or carbon sequestration) will be encouraged by the operation of this scheme as it is currently formulated.

Our preferred option would be for this scheme to be fundamentally redesigned, taking into account lessons learned from the design and performance of other environmental and financial markets.

Introducing formal review into the scheme

It is important to note that the draft legislation removes the “effectiveness audit” function previously provided by the NSW EPA, and does not replace it with any mechanism for formal review of the performance of the scheme. Should the scheme proceed, it is this issue that we feel most pressing requires amendment.

Under the NSW Greenhouse Benchmark scheme as originally introduced in 1995, the NSW EPA was given the task of conducting an audit of the effectiveness of the strategies after 3 years⁵.

A requirement of this kind also exists within the Federal Renewable Energy (Electricity) Act 2000 that enables the Federal Mandatory Renewable Energy Target. (MRET).

The Electricity Restructuring Group has used the clause⁶ from the Federal MRET legislation as the basis of a possible amendment to the NSW Bill.

It is to be acknowledged that conducting a review of this form does in itself introduce market uncertainty about future directions. There is, for example, anecdotal evidence that knowledge that the MRET review will commence in early 2003 is to some extent inhibiting forward trading of MRET Renewable Energy Certificates for 2004 and beyond. It is also a frequently heard complaint from electricity market participants that regulatory uncertainty is inhibiting investment.

Despite this, we feel on balance that given the importance of this scheme and the uncertainties that exist around the expected performance, some form of formal review carries benefits outweighing the possible market impact costs.

⁴ See, for example, the previously mentioned AGO paper for an interesting discussion of liquidity and administrative challenges with ‘baseline and credit’ markets.

⁵ Refer to Schedule 2 of the NSW Electricity Supply Act 1995, Section 6, (4) (b)

⁶ Refer to Clause 162 of the Federal *Renewable Energy (Electricity) Act 2000*

A possible amendment to incorporate an independent review of the operation of the NSW greenhouse gas benchmark scheme

The following proposed amendment is based very closely upon the equivalent section of the Federal Government Mandatory Renewable Energy Target legislation. (Refer to Clause 162 of the Federal *Renewable Energy (Electricity) Act 2000*).

Review of operation of Act

- (1) The Minister must cause an independent review of the operation of this Act, including consideration of:
 - (a) the extent to which the Act has:
 - (i) contributed to reducing greenhouse gas emissions; and
 - (ii) encouraged additional generation of electricity from renewable energy sources; and
 - (b) the extent to which the policy objectives of this Act have been achieved and the need for any alternative approach; and
 - (c) the mix of technologies that has resulted from the implementation of the provisions of this Act; and
 - (d) the level of penalties provided under this Act; and
 - (e) other environmental impacts that have resulted from the implementation of the provisions of this Act, including the extent to which non-plantation forestry waste has been utilised; and
 - (f) the possible introduction of a portfolio approach, a cap on the contribution of any one source and measures to recognise the relative greenhouse intensities of various technologies; and
 - (g) the level of the overall target and interim targets; and
 - (h) the performance and efficiency of the market considering, inter alia, design of the tradable instrument and frequency of trading
 - (i) the appropriateness and scope for further government action to address any shortcomings in market efficiency or effectiveness of the Act identified.

The following years are to be considered review years: 2005, 2007, 2009

The review is to begin as soon as practicable after the 1st January in each review year, and in any event before 30th March in each review year.

- (2) A person who undertakes such a review must give the Minister a written report of the review before the 30th June in each review year.
- (3) The Minister must cause a copy of the report of the review to be tabled in each House of the NSW Parliament before the 30th September in each review year.
- (4) In this section:

independent review means a review undertaken by persons who:

- (a) in the Minister's opinion possess appropriate qualifications to undertake the review; and

- (b) include one or more persons who are not employed by the NSW Government or a NSW Government authority and have not, since the commencement of the Act, provided services to the NSW Government or a NSW Government authority under or in connection with a contract.
- (c) Is not conducted or managed by a NSW Government Department, agency, or other private or public organisation that had or has carriage of either the implementation or ongoing operation of the subject of the review.