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Dr Kerry Schott AO
Independent Chair
Energy Security Board
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Dear Ms Schott,

RE: National Energy Guarantee Draft Detailed Design for Consultation

The Australian Industry Group (Ai Group) welcomes the opportunity to make a submission on the National Energy Guarantee Draft Detailed Design for Consultation Paper. This submission addresses both the Energy Security Board (ESB) elements and the Commonwealth elements released in June 2018. Ai Group represents thousands of businesses across an expanding range of sectors, from manufacturing to construction, defence, energy, technology, transport, waste and more. The overwhelming majority of our members are energy users, some of them very intensive, but we also benefit from the perspectives of businesses in the energy supply chain.

Ai Group continues to support the overall goals and approach of the Guarantee: resolving a durable long term framework for energy and climate policy through twin regulatory obligations on National Electricity Market customers to meet reliability and emissions objectives, with flexibility for contracting arrangements to ensure this can be achieved at least cost. The remainder of this submission addresses outstanding technical issues in detail. While there are refinements and amendments suggested, we are confident that these can be addressed and that the Guarantee remains the best opportunity for a policy mechanism on which electricity users, suppliers and investors can rely.

The most significant outstanding issue that has been raised by the greatest number of Ai Group's members is the proposal that large energy users be responsible by default for their share of the Reliability Obligation, with an 'opt-out' to pass responsibility to a retailer by agreement. Large users are concerned that this would put them in a weaker negotiating position with retailers, exposing them to costs that would outweigh the benefits that the ESB hopes to achieve by encouraging longer and more predictable contracting. We submit that it would be better to extend the proposed 'opt-in' arrangements to all large users, which would make retailers responsible for contracted load by default but enable large users to manage this directly if they prefer. Large users would still need to carefully manage their retail contracts in light of the potential for a looming reliability gap to raise costs. By managing their own risks with care and foresight, and opting in or contracting with retailers accordingly, large users will contribute to the efficient operation of the Reliability Obligation and the strength of the electricity system as a whole.

There are a range of important energy reforms under way beyond the Guarantee that will interact with it, and with each other. As the Finkel Review concluded, an integrated approach to energy is essential. One reform that is particularly important to the effective functioning of the Guarantee is the proposed requirement for generators to give three years' notice of closure. If this rule can be made effective it will be significant in its own right, while also providing much greater confidence that market customers and energy users will have adequate time to meet the Reliability Obligation.

This submission addresses both the ESB and Commonwealth elements of the Guarantee, to ensure coherence and consistency. We have provided it to the Commonwealth as well.

Should you wish to discuss this submission further, please contact our adviser Tennant Reed on (03) 9867 0145 or by email at tennant.reed@aigroup.com.au.

Sincerely yours,

Dr Peter Burn
Head of Influence and Policy

Issue (Reference)	Draft detailed design	Comment
Emissions Obligation elements (references are to the ESB Draft Detailed Design Consultation Paper unless otherwise noted)		
Emissions - Entities covered (ESB 3.3.1)	Design now proposes each market customer will manage reporting and compliance separately, rather than having default responsibility for any generation lie with the controlling corporation where a retailer and generator are related or integrated.	No objection to dropping the controlling corporation responsibility element if it is impractical to enforce.
Competition measures in emissions obligation (ESB 3.3.2)	In place of its controlling corporation responsibility element, ESB proposes several measures in the Emissions Obligation to foster competition: • the first 50GWh of a market customer's load would be exempt from the emissions obligation. The intent is to support retail market competition by making life simpler for small retailers. The exempted load would be spread across all other market customers, to ensure that overall targets are met. • New obligations on generators and market customers not to unreasonably withhold allocations from market customers. • Administrative requirement on generators to allocate all generation by the reporting and compliance date.	• 50GWh exemption: We would not want this to provide a distorting competitive advantage to small participants that leads to structuring and substantial burden shifting to customers of larger retailers. However, the low level of the threshold may help here; 50GWh is equivalent to a constant 5.7 megawatt load. Also, large retailers who restructured themselves would either be fairly obvious (if they did it all at once) or disadvantaging themselves (if they slowly cannibalised their retail load). Users are unlikely to misuse this provision, since the costs and responsibilities of becoming a NEM market customer are substantial compared to the potential savings on exempt load. In short, the 50GWh threshold may be helpful to support competition, and it does not seem to present significant risks of harm. • Obligation not to unreasonably withhold allocations. It is unclear why this element is needed; there are strong penalties against overallocation of generation volumes (ESB 3.3.2, below), an administrative requirement for generators to allocate to someone, and market customers choosing to overcomply would be incurring an opportunity cost. It is also not clear what would constitute an 'unreasonable' withholding. Unless the rationale and operation of this element can be satisfactorily articulated, this element should not proceed. • Administrative allocation requirement. This is reasonable to help ensure that market customers have full opportunity to acquire the generation volumes they require to comply.

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Incentive against over-allocation (ESB 3.3.2)	A market customer with too many megawatt-hours (MWh) of generation allocated to them would be assigned an assumed emissions intensity at the level of the most intensive generator in the market, and face a civil penalty. This is intended to prevent retailers hoarding excessive generation, which could make it impossible for other retailers to be fully compliant.	It is important that the MWh of liable load and covered generation match. This disincentive for hoarding seems sensible and should also encourage parties to contract earlier rather than leaving this until late in the compliance period. This provision does not and should not prevent a market customer from outperforming the annual emissions intensity target – they could still choose to achieve net zero emissions, for instance, by contracting with the necessary mix of generators. What they could not do is tip other customers into noncompliance by contracting for more generation than their own liable load.
Pre-1997 renewable generation – coverage (ESB 3.3.3)	Currently pre-1997 renewable generation that is excluded from the RET (largely hydro) would be included in the Guarantee. The ESB notes some stakeholders have expressed concern and says the treatment of this generation will be further considered.	The rationale for excluding pre-1997 generation in the RET is that the RET is intended to incentivise new renewable generation capacity only. The Emissions Obligation is different: it is technology neutral and takes account of all generation, new, old or upgraded. This in principle is a more efficient approach, since market participants can optimise across a wider range of options for compliance; and because under an electricity sector emissions constraint, every source of generation has an underlying value or disvalue for achieving the target. Attempting to excise this value as a 'windfall gain' risks overcomplicating the scheme and discouraging efficient decisions about the use or extension of old assets. Pre-1997 generation should stay in the Guarantee.
EITE exemption (load scaling issues) (ESB 3.3.3)	Exempt EITE load would be added back onto non-exempt load, by scaling it up after the compliance period. AEMO would publish a weekly estimate of how this scaling factor is tracking, based on EITE and non EITE load.	This seems a technically workable solution with adequate visibility. Note that EITE electricity demand is around 20% of total NEM demand, so liable load will be scaled up by around 20% in a typical year. To the extent that there are emissions compliance costs, an unexempted user will pay around 20% more for these than without an EITE exemption. Addressing trade exposure is essential and EITE is the most practical currently available framework for doing so, but the implications of scaling highlight that the first priority should be to ensure the NEG helps achieve a clean reliable electricity system while delivering the lowest sustainable prices to all users.
GreenPower load (ESB 3.3.3)	Propose to allow Greenpower to be additional by deducting generation and load from the Registry. However, note	GreenPower is important to customers, retailers, generators and governments and should be recognised in the Emissions Obligation. It

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	complications from relationship with RET and flag consultations with GreenPower Steering Group.	is appropriate for ESB to test and refine its proposed treatment in consultation with the GreenPower Steering Group.
Transparency of emissions registry (ESB 3.3.4)	The paper proposes that the emissions registry be accessible to market customers and generators,who would be able to see their own position and the unallocated generation of all generators but not the compliance status or load of other customers. The public could see this generally available information and there would be periodic releases of other information to the public, such as overall scheme performance and market customers' overall emissions intensity.	Transparency in the Emissions Registry is important to improve efficiency and maintain public confidence. We support the proposal that all market customers and the wider public be able to view the extent of unallocated generation at any given moment, as well as emissions intensities and evolving estimates of matters like EITE load. This information can be public and broadly accessible without allowing anyone but NEM participants to modify Registry entries or have generation allocated to them.
Flexible compliance – carry forward (ESB 3.4.1)	Overcompliance could be carried forward by market customers, limited to 5% of the intensity requirement plus 60kt CO2e. The carryover limit would be waived in any year where all market customers were compliant with the emissions target.	All flexibility options have a benefit – in limiting the potential for short term spikes in compliance costs due to passing circumstances – and a risk – that miscalculation in the flexibility option or wider policy design will undermine the effectiveness of the policy. With respect to carryover, there is the potential that if compliance proves easier than expected market-wide, unlimited carryover could limit the ability of the Guarantee to contribute to future targets. The carry forward limit should apply in all circumstances.
Anti avoidance (ESB 3.5.3)	ESB is considering an anti avoidance regime to prevent structuring or other steps to avoid the Emissions Obligation.	Further consultation is required, but in principle an anti avoidance regime makes sense.
Enforcement tools for emissions requirement (ESB 3.5.4)	ESB proposes a suite of compliance approaches including civil fines of up to $100m, and many gradations below this such as injunctions and a culture of compliance.	The proposed enforcement tools give the Australian Energy Regulator and the courts a range of effective options to enforce the Obligation and appear sensible. We have had some concern from members that the $100m cap on fines could produce results that are too weak to be meaningful or too onerous to be appropriate for different liable parties. It may be more appropriate to set the maximum penalty as a share of business revenue or an amount per MWh of load. Alternately, greater guidance could be given to indicate which factors should shape penalties within the allowable range. Ongoing monitoring will be needed of the effectiveness of the enforcement regime.

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Reliability Obligation elements (references are to the ESB Draft Detailed Design Consultation Paper unless otherwise noted)		
Forecasting the reliability requirement (ESB 4.2)	ESB states that "AEMO will continue to work with the Reliability Panel on the appropriateness of the current Reliability Standard in the face of an increasingly 'peaky' supply-demand balance. The intention of the Guarantee is to remain aligned to the Reliability Standard while ensuring there are adequate resources available to meet peak (as opposed to average) demand."	While we recognise that the electricity system is in the midst of substantial change, energy users are cautious about changes to the current Reliability Standard. Lifting reliability requirements in NSW and Queensland in the 2000s contributed to much of the extreme growth in network investment of the past decade, locking in high costs for energy users. We support the intention of the Guarantee to remain aligned to the current 0.002% Un Served Energy Reliability Standard.
Triggering the reliability requirement (ESB 4.5)	ESB proposes a decision on triggering the Reliability Obligation by an independent entity if AEMO requests such a trigger three years out from a projected shortfall. ESB has also requested feedback on a stakeholder proposal, made at the 2 July forum, that the three year trigger be scrapped to simplify the process – leaving a regular forecasting update process and an AEMO decision on procurement-of-last-report (and associated Obligation compliance) one year out from a forecast shortfall.	The stakeholder proposal to drop the three year trigger is interesting. Removing the trigger would simplify the scheme and remove a source of uncertainty. Liable parties would need to form their views about the regular reliability forecasts and the market response, but would not need to guess about an independent decision-maker. However, some of our members have expressed strong concerns that dropping the trigger may lead to a rapid invocation of compliance without adequate opportunity for liable parties to prepare. To guard against this, market customers might need to maintain constant readiness to comply, which may carry significant costs and exacerbate differences in the competitive position of different participants. Ai Group would not want a situation to arise where market customers are taken by surprise by compliance. Unless the ESB can design a simplified triggerless process where this risk is entirely avoided, we would not support dropping the three year trigger.
Liable entities / Large User direct responsibility for Reliability Obligation (ESB 4.5)	ESB proposes that the entities liable for the Reliability Obligation include not just market customers, but large user sites with 5MW or more of peak demand. Users below 5MW could 'opt in' to take responsibility from their retailer if they chose. Users at 5MW or above could 'opt out' by transferring responsibility to a retailer by agreement. ESB has acknowledged large energy user concern at the proposal they be responsible for managing the Obligation by default, and has signalled willingness to consult further on solutions.	We are not fully convinced of the benefits of default responsibility for large users ('opt out'), and are concerned about the potential costs. We acknowledge that all users will ultimately pay the costs of the Reliability Obligation if it is triggered, whether users or retailers start with the obligation. The question is whether these overall costs can be somewhat reduced, or somewhat increased, by opt in or opt out.

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		The main stated benefit of opt-out is that retailers find it hard to anticipate which large, lumpy industrial loads will be in their portfolio given often-short contracting periods, and they will extract a significant risk premium to manage this uncertainty. Users know their own load better. If large users by default must manage reliability themselves, some would have capacity to do so. But most would seek a retailer to manage this for them. In return for this, retailers will ask for longer contracts that enable them to manage reliability at lower overall cost. The potential cost of opt-out is that since most large users are poorly placed to manage the Reliability Obligation themselves, they will be in a weak negotiating position when asking retailers to take this on. Retailers could simply exploit this position to extract more favourable terms, without benefits for overall system cost. If retailers hold default responsibility but users can opt in, and the risk premium of unpredictable large user demand is substantial, this should lead retailers to offer large users contracts that reflect this (with higher prices for shorter contracts), and in particular to offer much higher prices in the event that a reliability gap is looming and compliance obligations are in danger of crystallising. Under opt-in, energy users who come out of contract close to a projected shortfall would be at risk either of high prices, a lack of retail contract offers, or receiving offers made only on the basis that they opt in to manage the Obligation. Our large energy user members are unanimous in their preference for opt-in over opt-out. They recognise that they will still need to understand the state of the electricity market and act responsibly to manage their risks. In so doing, they will contribute to the cost-effective development of the electricity system as a whole. We therefore recommend that market customers be responsible by default for their whole load, with an opt in for any energy user. This would also require a consequential change to the position at ESB 4.8, where ESB proposes that liable entities be able to apply to adjust their contract positions after T-1 to reflect a material change in

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		circumstances, such as where a retailer has taken on additional large commercial and industrial customers that are below the 5MW threshold. If the above recommendation is accepted, the 5MW threshold should be removed and adjustment should be available with respect to any new C&I load. If the ESB is unwilling to move from opt-out to opt-in, a distant second-best option would be to raise the 'opt out' threshold substantially above 5MW to ensure that it only affects users more likely to have the internal capability to efficiently manage the obligation themselves. Discussions with members suggest that many more businesses may be at or above the 5MW threshold than ESB previously estimated, including for instance a range of cold storage facilities; this wider coverage increases potential costs beyond the potential increase in covered load. 100MW may be a more appropriate threshold, covering most of the currently targeted demand with many fewer entities involved. However, this would still put directly responsible energy users in a difficult position. Our strong preference is opt-in for all energy users.
Qualifying contracts (ESB 4.6)	ESB proposes that qualifying financial contracts must either have been bought on a centrally cleared market or recorded in a trade repository of OTC derivatives; and that a Market Liquidity Obligation (MLO) apply to large gentailers, obliging them to offer contracts on a centrally cleared platform during a reliability gap and post bid and offer spreads. The ESB seeks feedback on whether the previously flagged voluntary 'book build' coordinated by AEMO would still be needed if an MLO applied. Demand response contracts could also qualify (as distinct from financial contracts where the seller may use many physical means including demand response to manage their financial risk).	On its face the MLO combined with a trade repository seems an appropriate way to support competition by supporting wider access to qualifying contracts in the event that the Reliability Obligation is triggered.
Qualifying contracts – grandfathering (Technical working paper on Qualifying Contracts 3.5)	ESB proposes that existing contractual arrangements by liable large users be grandfathered and treated as qualifying contracts, as long as they are used to reduce exposure to the spot price; are executed prior to the release of the High Level Design (20 April 2018); and cover the period of the reliability gap.	Grandfathering existing liable large user contracts makes sense. A cut-off date is necessary to limit the application and prevent abuse. However, many large users have been developing and finalising power purchase agreements over the past year, several of which were not executed until shortly after April 20. Given the amount of work required

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		to develop these agreements and their substantial financial importance to the businesses concerned, there can be no question of their being developed or influenced as a result of the 20 April paper's single sentence comment on existing contracts. We recommend that a later cut-off be specified, such as 30 June 2018. The rules around grandfathering will also need to be aligned with the resolution of the opt-in/opt-out treatment of large users.
Penalties (ESB 4.9)	ESB propose that noncompliant entities bear a proportionate cost for MW of noncompliance, and face additional compliance and penalty options ranging up to $1m for a first offence and $10m per repeat offence.	As argued above with respect to ESB 3.5.4, the proposed maximum fines may be too low in some cases and too high in others. Defining penalty maxima as shares of business revenue would reduce the scope for inappropriate fines, and providing further guidance on the criteria for higher penalties would be useful.
Commonwealth design elements (references are to the Commonwealth Draft Detailed Design paper unless otherwise specified)		
Setting and reviewing the electricity emissions target (Cth 2)	The Commonwealth proposes to set in legislation annual electricity emissions targets for 2020-30 and to extend these (presumably through regulations) by five years in 2025 and every five years thereafter, aligned to processes around extending Australia Nationally Determined Commitments under the Paris Agreement.	We appreciate the intention to provide maximum investor certainty through a long and fixed initial target period. However, the appropriate level of emissions reduction ambition for the electricity sector remains the subject of intense disagreement between political parties and levels of government, as well as among stakeholders. Attempting to fix the target over such a long period, without significant amendment processes or opportunities for broader consideration or review, is in fact likely to produce a brittle target that will not survive changes of government or offer credible guidance to investors. We recommend that the Commonwealth legislation allow for the issuance of targets by the Minister through subordinate legislation, and prescribe certain limits and procedural requirements on this issuance. These could include: • a minimum notice period of changes, following the first issuance, of three to five years; • a 'speed limit' on year-to-year movement in targets;

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		• a requirement to have regard to Australia's international commitments, including the Paris Agreement and our Nationally Determined Commitments under it; • a requirement to have regard to the economy-wide task of meeting Australia's commitments across all sectors efficiently and equitably; • a requirement for extensive consultation, transparency over the decision-making and clear stakeholder advice. While such a target setting system on its face provides for more potential change, in practice it is more likely to endure than more brittle approaches, and can provide greater guidance to energy users, suppliers and investors.
Implementing the EITE exemption (Cth 3)	The Commonwealth proposes to replicate the current EITE exemption arrangements from the RET, with some streamlining, to exempt EITEs from the Emissions Obligation.	Avoiding distortions to trade competitiveness from the uneven application of climate policies in Australia and overseas is a key priority in the design of effective climate policy. While it is imperfect, the EITE exemption approach is the most practical and available current method of achieving this, and we support its use at this time. However, given that EITE is an imperfect tool that applies to only some trade exposed activities with boundaries and processes set long ago in different policy and market circumstances, it will be important over time to update the EITE activities and approach to ensure it is as effective, fair and relevant as possible. Regular reviews are needed, including wide industry and stakeholder consultation. In addition, as discussed above with respect to ESB 3.3.3, the EITE exemption necessarily means that if there are substantive compliance costs for the Emissions Obligation – which there may not be, in light of the sea changes underway in electricity markets – non-exempted users, including most businesses and all households, would pay more for the exempted share of demand. This highlights the overriding importance of ensuring that the Guarantee, and wider energy policy, help deliver reliable and clean energy to all customers at the lowest sustainable cost.

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External offsets (Cth 4)	The Commonwealth is still considering whether to allow offsets, but suggests a framework where offsets (including domestic offsets and, potentially, international units consistent with yet-to-be-finalised rules under the Paris Agreement and equivalent in quality to domestic offsets) could be used, up to an annual market-wide limit and with the potential for limits on individual market customers' use as well.	Domestic offsets and international units are two of several potential sources of flexibility to limit the risk that passing circumstances inflate compliance costs for some market participants well above those of others. They can also be tools to help equalise abatement costs across different sectors or economies and ensure abatement occurs where it is most efficient. Against this, offsets and other sources of flexibility can bring instability or amplify the effects of errors and anomalies in connected mechanisms. Ai Group is broadly supportive of Australian climate policy making use of international abatement opportunities where cost effective to ease the substantial long term transition we have committed to through the Paris Agreement. However, as previously submitted, the specific legal and market uncertainties around international units currently make them unsuitable to include in the Guarantee, whose coequal purpose is to restore a greater degree of investment certainty to the electricity sector. An exclusion of international units should be reassessed at regular intervals, perhaps every five years, taking into account Australia's evolving targets and the situation of all sectors. Domestic offsets are considerably better understood and could be appropriate to include in the Guarantee. A market-wide quantitative limit, and a symmetrical limit on the use of offsets in any one year by any one market customer, would respectively give confidence that the Obligation and electricity system could not be undermined by unexpected problems in the offset market, and that all customers would have access within the limit.