Business Council of Australia

SUBMISSION

National Energy Guarantee

Draft Detailed Design Consultation Paper

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The Business Council of Australia draws on the expertise of Australia's leading companies to develop and promote solutions to the nation's most pressing economic and social policy challenges.

ABOUT THIS SUBMISSION

The Business Council supports the development of an integrated, national and bipartisan energy and climate change policy framework that can deliver the following four key goals:

- secure and reliable energy supply
- affordable energy supply
- strong, internationally competitive economy
- meet current and future absolute emission reduction targets.

In October 2017 the Energy Security Board (ESB) provided advice to the COAG Energy Council on a proposed mechanism that would integrate energy and climate change policy by placing both a reliability and an emissions obligation on electricity retailers – known as the National Energy Guarantee (the Guarantee).

In March 2018, the Business Council provided feedback on the proposed 'high-level design options' for the Guarantee. The high-level design was presented to COAG Energy Council in late-April 2018 and the Guarantee was progressed to the detailed design phase.

This submission responds to the recent ESB and Commonwealth papers on the draft detailed design.

KEY RECOMMENDATIONS

- The Business Council strongly supports the implementation of the National Energy Guarantee. The Guarantee provides a credible pathway forward by putting an end to the policy paralysis and providing a circuit-breaker for the stale energy and climate change policy debate in this country.
- The Business Council welcomes technology neutrality as an overarching principle for the design of the Guarantee. This will minimise the opportunity for governments to pick winners and should lead to least-cost solutions.

Commonwealth Government elements

- The Business Council supports an electricity sector target of a 26 per cent reduction on 2005 levels by 2030. This is consistent with the national target and ensures that the electricity sector is contributing a pro rata share of the national abatement task.
- The Business Council supports the proposed five-yearly review of electricity emissions targets, to align with the review and refine cycle under the Paris Agreement. Although the initial target will be set for a fixed 10-year period to provide maximum investor confidence, the subsequent five-year review and notice also provides sufficient flexibility in response to changing technology costs, market conditions and changes in demand.
- The Business Council supports an exemption for emissions-intensive trade-exposed (EITE) activity from the emissions requirement under the Guarantee. We support this exemption being administratively and regulatory aligned with the current EITE activity exemption under the Renewable Energy Target (RET).
- The Business Council supports limited access to offsets external to the electricity sector – both international and domestic – as a flexible compliance option to meet the emissions requirement under the Guarantee.

Energy Security Board elements

- The Business Council supports increasing the amount a market customer is permitted to carry forward over-achievement so that market customers have maximum flexibility in meeting the emissions requirement and can do so at least-cost.
- The Business Council supports initially leaving reliability obligation on the retailer to manage on behalf of large users, with an option for these businesses to step in and manage the obligation if they believe it is more efficient and cost effective to do so.
- The Business Council recommends the ESB work closely with the ACCC in relation to any competition issues arising out of the design of the Guarantee. The ACCC is completing an inquiry into retail electricity prices and will be best placed to provide advice on how to overcome any competition issues.
- The Business Council supports the implementation of the Guarantee through existing governance arrangements in the NEM, following the agreement of COAG Energy Council. Consideration should be given to what aspects of the Guarantee are embedded in the National Electricity Law and what design features can be implemented in the National Electricity Rules.

EXECUTIVE SUMMARY

The Business Council supports the development of an integrated, national and bipartisan energy and climate change policy framework that can deliver the following four key goals:

- secure and reliable energy supply
- affordable energy supply
- strong, internationally competitive economy
- meet current and future absolute emission reduction targets.

The proposed National Energy Guarantee provides a credible pathway forward. The Guarantee can put an end to the political impasse and policy paralysis and be a circuit-breaker for the stale energy and climate change policy debate in this country.

Our energy system is undergoing a major transition. To manage this transition and regain our competitive advantage in energy, Australia needs an approach to energy policy that strikes a better balance between promoting our economic growth, energy security, and environmental sustainability. To date this has not been achieved and consequently the National Electricity Market (NEM) is facing a trilemma.

An influx of renewable intermittent generation and an ageing fleet of baseload generation, combined with the uncertainty around how we intend to treat emissions in this country, has resulted in an investment freeze in dispatchable generation, an inherent reliability risk to the grid and ultimately higher electricity prices for consumers.

By relying on existing market structures and placing responsibility for meeting emissions and reliability targets on retailers, the Guarantee is our best chance to drive the investment we need in the energy sector, while also meeting our emissions reduction targets.

Not only do Australians expect reliable energy but Australian businesses and industry rely on a significant amount of baseload and dispatchable power for their operations and to stay competitive globally. However, uncertainty over how Australia will meet its international commitments to reduce emissions has stalled investment in this critical source of energy and resulted in a looming reliability threat over our electricity market. While a significant amount of renewable capacity has been invested in under the Renewable Energy Target (RET), this intermittent source of energy cannot be relied on to consistently power our homes, cities and industries. Therefore, the reliability obligation seeks to balance the influx of renewable generation coming into the market with adequate dispatchable generation – whether it be coal, gas, hydro or batteries – to ensure the lights stay on when the sun isn't shining or the wind isn't blowing.

The advantage of the Guarantee is that it is technology neutral. It puts an end to the government picking technology winners and levels what has been an uneven playing field for certain fuel sources. By placing a reliability obligation on liable entities to ensure there is adequate dispatchable power in the system, there will be an incentive to upgrade our existing fleet of dispatchable and baseload generators to make these assets more efficient and more flexible to meet the demands of our transitioning electricity market and the obligations under the Guarantee.

At the same time, the emissions obligation will encourage retailers to contract with renewable generation to lower their carbon profile and meet emissions reduction targets.

It will be a commercial decision for retailers to determine the most appropriate mix of generation to meet their customer loads whilst also being compliant with the twin obligations under the Guarantee. By harnessing existing market structures and contracting arrangements, the Guarantee will not impose any new instruments that risk driving up prices or giving preference to a particular fuel source.

The durability of the mechanism under the Guarantee will provide much needed investor confidence in how emissions will be treated in the electricity sector, as well as providing an incentive for investing in existing and new dispatchable generation sources. This will bring on more supply and encourage greater and longer contracting which, in turn, will put downward pressure on wholesale electricity prices.

The Business Council calls on all political leaders to put an end to this tired debate, support the implementation of the Guarantee and install an enduring mechanism that will prioritise the reliability of the grid, reduce emissions in the electricity sector and improve affordability for all Australians.

COMMONWEALTH ELEMENTS

TARGET

Unconstrained climate change would have serious economic, environmental and social consequences for Australia.

The 21st Conference of the Parties meeting in Paris in December 2015 reached an historic agreement (the Paris Agreement) to limit global temperature rises to 'well below two degrees Celsius.' To achieve this, deep global emissions reductions will be required with most countries, including Australia, eventually reducing net greenhouse gas emissions to zero.

In 2016 the Australian Government ratified the Paris Agreement and set a target to reduce Australia's emissions by 26 to 28 per cent below 2005 levels by 2030.

However, policies to address climate change must not come at the expense of a secure, reliable and affordable energy system. Climate change policy objectives must be grounded in our broader objective to secure Australia's future prosperity and deliver meaningful jobs for Australians. Our climate change policies must therefore support business competitiveness and promote economic growth, both of which are founded on secure, reliable and affordable electricity and gas.

The Business Council believes that the Guarantee will put in place a durable mechanism that appropriately balances our economic growth, energy security, and environmental sustainability. The emissions reduction obligation seeks to put an end to the uncertainty around how we intend to treat emissions in this country. For more than a decade, ad hoc climate change policy and political wrangling has clouded investment decisions in the NEM. This has resulted in a less stable and reliable system while driving up power prices for business, industry and households.

The Guarantee has the potential to put an end to this uncertainty. But the durability of the mechanism is also dependent on how the emissions reduction target is initially set and changed in the future. As the Guarantee not only imposes an emissions reduction mechanism, but also a reliability mechanism designed to provide a clear long-term investment signal for new dispatchable generation in the NEM, it is essential that the process for setting future targets delivers certainty and confidence for business when making investment decisions.

Therefore, the Business Council supports an electricity sector target of a 26 per cent reduction on 2005 levels by 2030. This is consistent with the national target and ensures that the electricity sector is contributing a pro rata share of the national abatement task.

The Commonwealth Government has proposed setting annual electricity emissions targets for an initial 10-year period from financial year 2021 to 2030. A linear emissions reduction trajectory to 2030 will be implemented. The target would be reviewed and extended in 2025 for the period of 2031 to 2035 and every five years thereafter.

While we support the electricity emissions target under the Guarantee being scalable to meet future emissions reduction targets under the Paris Agreement, this must be balanced against investment risk and uncertainty. Setting an initial 10 years of targets will provide the market with maximum certainty to drive investment in new generation capacity.

The Business Council supports the proposed five-yearly review of electricity emissions targets, to align with the review and refine cycle under the Paris Agreement. Although the initial target will be set for a fixed 10-year period to provide maximum investor confidence, the subsequent five-year review and notice also provides sufficient flexibility in response to changing technology costs, market conditions and changes in demand.

Importantly, the Guarantee's enduring five-yearly review cycle, combined with the five-year notice period, aims to protect investment decisions from the vagaries of politics and changing governments that has resulted in the current policy paralysis.

The timeframe will also ensure that changes to the target are properly considered. The Business Council supports implementing a framework that requires the government to undertake and publish a cost-benefit analysis of any proposed change to the target, including the price implications for sectors of the economy as well as undertaking a Regulatory Impact Statement.

KEY RECOMMENDATIONS

- The Business Council supports an electricity sector target of a 26 per cent reduction on 2005 levels by 2030.
- The Business Council supports the proposed five-yearly review of electricity emissions targets, to align with the review and refine cycle under the Paris Agreement. Although the initial target will be set for a fixed 10-year period to provide maximum investor confidence, the subsequent five-year review and notice also provides sufficient flexibility in response to changing technology costs, market conditions and changes in demand.

EITE EXEMPTION

The Business Council has consistently supported an exemption for emissions-intensive trade-exposed (EITE) activity from emissions reduction policy. This recognises the need to maintain the international competitiveness of Australia's trade-exposed sectors, in the context of uneven global commitments to reduce emissions.

We welcome the government's proposal to maintain consistency with the RET and exempt all EITE activities eligible for exemption from the RET from the emissions requirement under the Guarantee. By aligning the RET exemption process and Guarantee exemption process the administrative burden and compliance cost will be minimised for EITE entities. We call on the government to work closely with EITE stakeholders in finalising the regulatory process to ensure a fit-for-purpose exemption is implemented under the Guarantee.

Although it is understood that the government does not intend to revisit the definition of EITE 'activity' in transferring the exemption across to the Guarantee, we ask that future reviews of this definition take into consideration the exemption's application to LNG production.

KEY RECOMMENDATIONS

- The Business Council supports an exemption for emissions-intensive trade-exposed (EITE) activity from the emissions requirement under the Guarantee. We support this exemption being administratively and regulatory aligned with the current EITE activity exemption under the Renewable Energy Target (RET).

OFFSETS

The Business Council has consistently supported emissions reduction policies that allow access to credible domestic and international permits to ensure compliance can be managed at least-cost. In particular, access to credible, high-quality international permits as a means for businesses to acquit their emissions liability at least-cost must be considered as part of the development of long-term, whole-of-economy emissions reduction strategy.

Access to international permits recognises the fact that climate change is a global problem and it does not matter where abatement occurs. Australia is committed to doing its part to reduce emissions but we must ensure that Australian businesses remain globally competitive and are able to meet abatement targets at least-cost.

The Commonwealth Government is considering whether retailers should be permitted to use offsets external to the electricity sector as a flexible compliance option to meet the emissions requirement under the Guarantee.

The Business Council strongly supports the availability of external offsets – both domestic offsets such as Australian Carbon Credit Units (ACCUs) and international permits – being included in the design of the Guarantee as part of the suite of flexible compliance options required to meet the emissions requirement. If the Guarantee is going to facilitate a reduction of emissions at least-cost, then access to external offsets to help retailers meet their obligation year-to-year will be important.

Access to external offsets will be of increasing importance if, and when, the electricity emissions target is scaled-up. Retailers are likely to require various compliance options including offsets, together with banking and borrowing options, to meet targets and smooth their obligations year-to-year. Offsets will also assist retailers manage the unpredictability of building and contracting with new generation assets. It can often be difficult to predict when large-scale energy investments will come online. This could have a significant impact on a retailer's portfolio mix and ability to meet their emissions obligation. Access to external offsets would assist in managing these issues and help smooth the cost of the scheme over time, rather than risk retailers breaching the target and being subject to penalties.

The overarching purpose of the Guarantee is to 'provide a clear investment signal so the cleanest, cheapest and most reliable generation gets built at the right place at the right time.'[1] The design of the compliance regime under the emissions requirement cannot be allowed to undermine this. Indeed, there is trade-off between meeting the requirement and maximising compliance flexibility. A balance must be struck between flexibility and least-cost options for compliance and achieving the primary objective of the mechanism – providing a long-term investment signal in the NEM that will ensure a reliable system and put downward pressure

[1] Energy Security Board, *National Energy Guarantee Draft Design Consultation Paper*, 15 February 2018, p. 5.

on prices. Therefore, if offsets are permitted to be used for compliance, the limitations on the amount available should be considered.

KEY RECOMMENDATIONS

- The Business Council supports limited access to offsets external to the electricity sector – both international and domestic – as a flexible compliance option to meet the emissions requirement under the Guarantee.

ENERGY SECURITY BOARD ELEMENTS

EMISSIONS REQUIREMENT

As currently designed, the Guarantee is a platform for a durable, bipartisan, national emissions reduction policy in the electricity sector that can achieve our committed international targets at lowest possible cost while maintaining our competitiveness.

Flexible compliance

The Business Council supports designing the Guarantee so that retailers have maximum flexibility in complying with the emissions requirement.

Given that the electricity emissions target is initially to be set to 2030, permissible year-to-year variations and flexibility for retailers to meet their annual emissions requirement will have no material impact on the NEM-wide target in the medium to long term. Greater flexibility and less stringent rules will mean, however, a reduced burden on retailers and a reduction in the costs imposed by the mechanism – costs that will ultimately be borne by business, industry and households.

Carrying forward over-achievement

The ESB is proposing that market customers will be able to carry forward a limited amount of a previous compliance year's over-achievement for use in later years. The ESB is recommending that a market customer will be permitted to carry forward an amount of tCO_2-e of up to:

- 5 per cent of the emissions intensity reflected in the target for the first year of the emissions reduction requirement for each MWh of load, plus
- a fixed amount of 60,000 tCO_2-e.

Although this limit would not apply if all market customers meet their emissions obligation in each compliance period, because this could only be assessed *after* the compliance period had ended, market customers would need to behave as if the limit applied.

The Business Council supports increasing the amount a market customer is permitted to carry forward so that market customers have maximum flexibility in meeting the emissions requirement. While there is some concern that allowing unlimited carrying forward of over-achievement could lead to anti-competitive stockpiling and make it more difficult for smaller market customers to comply with the emissions reduction requirement, at this stage this is hypothetical. The Business Council recommends increasing the initial limit to at least 10 per cent and, should anti-competitive behaviour arise or a shortfall of emissions reduction emerge, the limit can be revisited and updated through the rule-change process.

KEY RECOMMENDATIONS

- The Business Council supports increasing the amount a market customer is permitted to carry forward over-achievement so that market customers have maximum flexibility in meeting the emissions requirement and can do so at least-cost.

RELIABILITY REQUIREMENT

The Business Council supports placing a reliability requirement on retailers to create an incentive to invest in dispatchable generation. The reliability and security of our energy system must be prioritised as we transition to a lower-emissions future.

The Business Council acknowledges the ESB has adopted a minimalist approach to market intervention when undertaking the detailed design of the reliability obligation. The costs associated with an intrusive, complex and burdensome mechanism would be significant but the current design recognises this and the importance of maintaining liquidity in the electricity contract market.

Liable entities

The Business Council notes the ESB's proposal that large customers with a load above a threshold of 5 MW, measured as peak demand at a single site (NMI), will be liable entities under the reliability requirement.

We understand that the ESB's policy rationale behind this proposal is to ensure that should the reliability requirement be triggered, the majority of the load, of which large users make up about 20 per cent, is contracted. The ESB suggests that shifting the obligation from retailers onto large users will incentivise these large users to enter into longer contracts for dispatchable generation, which will provide retailers and generators with the certainty to make investment decisions in these assets.

However, the Business Council does not see the need to transfer the obligation onto large users for this to occur. Therefore, the Business Council supports initially leaving the obligation on the retailer to manage on behalf of large users, with an option for these businesses to step in and manage the obligation if they believe it is more efficient and cost effective to do so. This will still ensure that the majority of the load is contracted at T-1 by placing an obligation on the retailer to manage this risk on behalf of their large customer.

KEY RECOMMENDATIONS

- The Business Council supports initially leaving reliability obligation on the retailer to manage on behalf of large users, with an option for these businesses to step in and manage the obligation if they believe it is more efficient and cost effective to do so.

Market Liquidity Obligation

The purpose of the Guarantee is to achieve three primary objectives:

- a more reliable energy system
- a more affordable energy system and
- reduce our emissions and meet our international commitments.

Throughout the design process, the Business Council has called on the ESB to adopt a minimalist approach to market intervention in designing the reliability obligation. One of the main goals of the Guarantee is to put downward pressure on prices, but an intrusive and overly complex reliability obligation threatens imposing significant costs on retailers and other market participants that will ultimately flow through to consumers.

The proposal to introduce a Market Liquidity Obligation should be carefully considered by the ESB in consultation with electricity retailers and other key stakeholders. While we understand the rationale behind the proposed obligation is to manage potential transparency, liquidity and competition issues arising from the reliability requirement, it is equally as important to ensure that retailers are not burdened with the costs associated with an intrusive and complex compliance regime.

The ACCC is currently undertaking an inquiry into retail electricity pricing with its final report due to be released imminently. This comprehensive inquiry is best placed to address any competition issues in the market and the ESB should have regard to the final report as it finalises the detailed design of the Guarantee.

The Guarantee must focus on achieving its primary objectives. The reliability obligation is not expected to be triggered in the near term, so there is sufficient time to finalise the details of the Market Liquidity Obligation if it is required in the future.

KEY RECOMMENDATIONS

- The Business Council recommends the ESB work closely with the ACCC in relation to any competition issues arising out of the design of the Guarantee. The ACCC is completing an inquiry into retail electricity prices and will be best placed to provide advice on how to overcome any competition issues.

GOVERNANCE

The Business Council supports the implementation of the Guarantee through existing governance arrangements in the NEM, following the agreement of COAG Energy Council.

Embedding the Guarantee in the Australian Energy Market Agreement (AEMA) and the National Electricity Law (NEL) means that changes could only be made with the agreement of COAG Energy Council.

Such an approach ensures certainty, stability and confidence in the enduring operation of the policy as it is removed from the vagaries of politics and requires widespread agreement to be changed or amended.

Therefore, if agreed to by COAG Energy Council, the Guarantee will be entrenched in the broader energy governance framework so that it can provide the clear, long-term investment signals required to achieve reliability and affordability in the NEM, as Australia transitions to a lower-emissions energy system.

However, careful consideration should be given to what components of the design are implemented in the NEL compared with the National Energy Rules (the Rules). As would be the case with any new policy or mechanism, unforeseeable technical issues may arise after the scheme commences or small adjustments may be required. By implementing components that may require flexibility and adjustment in the Rules, these design features can be updated by the Australian Energy Market Commission's (AEMC) rule-change process, which is much more accessible than what is required to amend the NEL.

KEY RECOMMENDATIONS

- The Business Council supports the implementation of the Guarantee through existing governance arrangements in the NEM, following the agreement of COAG Energy Council. Consideration should be given to what aspects of the Guarantee are embedded in the National Electricity Law and what design features can be implemented in the National Electricity Rules.

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