



Dr Kerry Schott AO, Chair
Ms Clare Savage, Deputy Chair
Energy Security Board
Lodged via info@esb.org.au

Thursday, 08 March 2018

Dear Mses Schott and Savage,

National Energy Guarantee – Draft Design Consultation Paper

ENGIE in Australia (ENGIE) appreciates the opportunity to comment on the Energy Security Board's National Energy Guarantee Draft Design Consultation Paper.

ENGIE recognises the significant body of work, within a very compressed period that has gone into development of the National Energy Guarantee (NEG) and congratulates the Energy Security Board (ESB) on this basis.

ENGIE and the wider ENGIE Group have significant experience operating thermal generation and renewable assets within the National Energy Market (NEM) and across the world where the ENGIE Group has a presence in 70 countries, as well as strong core businesses in natural gas and energy services. Notably, the ENGIE Group is undertaking a significant programme of asset rotation within Australia and globally in recognition of the energy transition. Within Australia, ENGIE also has a significant retail presence, in excess of 650,000 customers, through its wholly owned retail company, Simply Energy.

ENGIE can draw on international experience to attest that there is value in assessing market performance, building upon successes, and preparing markets for changing dynamics. Notwithstanding this, ENGIE's experience also reveals that the pursuit of reforms that do not address clearly stated problems prevents rigorous assessment of potential solutions, and can force reform upon markets that will have negative or at the very least unintended consequences.

With this in mind, ENGIE's position on the NEG is that it supports the implementation of an emissions guarantee subject to improved mechanisms for managing the retailer obligations as discussed below. In relation to the reliability obligation, ENGIE has strong doubts the obligation as conceived will be effective and is not convinced the





mechanism should be recommended to the Council of Australian Government's Energy Council in its proposed form when alternative arrangements are likely to be less intrusive and more consistent with existing market design.

Each of these issues is enunciated below and ENGIE welcomes the ESB's further consideration of the NEG in the coming months and is available to discuss these matters at the ESB's convenience.

More broadly, if there is a fundamental belief that the NEM is no longer acceptable during energy transition – either as a market mechanism or it lacks community and political support – then a broader discussion is required. The NEG should not create a process of fundamental market redesign by stealth or accident. A wholesale change, whether towards a capacity market or something else, requires a broad and integrated review of policy expectations, what best meets consumers' needs, and market sustainability.

Emissions obligation

The emissions obligation requires some clarification and simplification but has ENGIE's in-principle support. ENGIE's comments and recommendations in relation to the obligation follow.

- ENGIE notes that workable arrangements for the emissions obligation could be placed on generators; however, ENGIE accepts that the emission obligation is to be placed on retailers and believes if the mechanisms is appropriately implemented this should be manageable through existing retail contracting practices.
- ENGIE accepts that the Government sets the emissions trajectory for the sector based on Australia's Paris commitments but notes that there needs to be clear governance arrangements in place. This means the rules for administration of the guarantee should be clearly articulated and subject to a clear process of review to minimise the risk of sudden change. ENGIE initial comments on setting and sectoral compliance are set out below.
 - ENGIE needs certainty around the trajectory profile with minimal risk of significant changes within a short space of time to enable forward contracting and clear compliance targets derived from a sectoral obligation.
 - The emissions target and trajectory should be managed by an agreed review window where emissions trajectory, which informs obligations, are set. Five-yearly reviews will provide appropriate certainty in the absence of possible firm triggers for early review of the back years.
 - Electricity sector obligations should be calculated annually and be NEM-wide. Consideration of how generation outside the NEM contributes to the target is required.
 - ENGIE understands there are competing views on the emissions burden that should be carried by the electricity sector. A clear process for setting the initial obligation should be put in place with an extended lead time. ENGIE remains concerned about the state-based schemes operating alongside



the national target. These approaches should be coordinated into a single target noting that it is clear that multiple policy levers are likely to remain in place going forward and the manner in which they coordinate needs to be concluded.

- ENGIE has a preference for a simplified emissions obligation managed through existing financial contracts traded between those with an emissions obligations (notionally retailers) and those who generate emissions/reductions. The points below deal with how ENGIE suggests the emissions obligations be structured.
 - The assessment of positions should occur on an annual basis to minimise compliance and ensure any position is not required to be measured on a short time frame basis (i.e. half-hourly) basis by the regulator which is wholly unmanageable.
 - The emissions obligation does not create a mandatory requirement for measurement of emissions for individual contracts so as to reduce the regulatory burden. ENGIE does not believe a new formal government administered registry is required. Existing trading systems can record intensity data where required which can be made available to the regulator as appropriate.
 - Where individual contracts are registered voluntarily this should occur through the existing authorised depository used by the market (i.e. DTCC et al). Where emissions are unstapled and exchanged these will need to be registered as emissions only through the same authorised depository. ENGIE expects most participants will choose to utilise the authorised depository as opposed to their own trading records. In either case, this approach will significantly reduce the regulatory burden that is likely to arise from creating a new government registry..
 - ASX traded contracts will not have an associated intensity and the market should be left to evolve products which represent a t-CO₂/e. Emissions associated with ASX trades will need to be managed separately and registered by the buyer and seller where exchanged.
 - OTC's can be unstapled; however, where the buyer and seller wish to staple emissions and electricity this is possible through the existing authorised depository.
 - Contract forms, likely the AFMA carbon addendum, will need to be standardised to ensure fungibility and identification of a separate position to the electricity position relevant to the underlying contract. This will also ensure derivatives trading becomes possible and have the chance of being a deep liquid market environment.
 - ENGIE requests the ESB undertake further work on the risks of allowing compliance with the emissions obligation via physical settlement. It could be argued that this will encourage further vertical integration and minimise liquidity; both outcomes that should not be supported by policy.



- ENGIE suggests the emissions obligation allow for generous banking and borrowing provisions over a rolling cycle. Given obligation is settled nationally in 2030, and other policies like 3 year notification for plant closure, there is a strong case for very flexible requirements around the timing of surrender. Further, where a more ambitious target is proposed the use of banking and borrowing becomes more important.
- Interaction of Renewable Energy Target compliance and emissions obligation requires further consideration. Potentially, the Renewable Energy Certificates and the emissions obligation compliance should be interoperable to minimise risk of double counting or two separate parties claiming benefits under separate schemes.
- International certificates are not necessary but ENGIE is aware there is strong interest from some participants and believe a small allowance could be allowed up to an agreed and relatively low percentage to the extent it doesn't undermine domestic contract liquidity but supports routes to market for retailers to acquire emissions abatement. Likewise, domestic ACCUs should be eligible under the scheme to meet trajectory targets to ensure cost burdens on industry are minimised.

Reliability obligation

ENGIE has a number of fundamental concerns about the reliability guarantee but appreciates its overall objective. As a starting position, ENGIE considers the reliability obligation may be more effective if it relies on the existing market settings in conjunction with some select elements of the proposed reliability guarantee.

Even if the ESB does not agree with ENGIE's position and elects to recommend the current model to the Council of Australia Government's Energy Council, gradual change is required given participants have already taken contracted positions in the market. This suggests select elements of the initiative should be adopted for 2019 as opposed to the entire reliability guarantee.

- ENGIE notes, the NEM is not facing any immediate reliability crisis and ENGIE has greater concern around the ability of the market to manage short term challenges and ensuring AEMO have the appropriate tools to meet its operational needs.
 - It is not clear that retailers are not already contracting to match their load exposure. In ENGIE's experience this is the case. In fact, the closure of Northern Power Station and mothballing of Pelican Point Power Station were in part driven by a lack of contracting by commercial and industrial customers. To the extent that mandatory contracting is proposed to overcome this concern, this should apply to those parties which evidence shows are not contracting to ensure the investment required to meet their needs occurs.
 - Thus, ENGIE notes a temporary measure could be mandatory contracting 12 months in advance for large loads that are not contracted with a retailer. This obligation could be instituted for a period of 3-5

years to ascertain whether such an approach changes market dynamics positively. This is justifiable on the basis those large loads have been very concerned by price rises that have eventuated as a consequences of retirements and mothballing.

- ENGIE notes generators and intermediaries are already active participants in the financial markets trading three times physical supply per annum on average, thus apart from the impact compulsory contracting may have on large loads, it is unclear how the reliability obligation will change existing market dynamics.
- ENGIE notes that some electricity market concerns may in fact be driven by prices and supply dynamics driven by gas supply which of themselves do not suggest a failure of the NEM. To the extent, that gas market dynamics are creating challenges, the reliability obligations will not of itself change these outcomes.
- ENGIE suggests the reliability obligation may not be required if policy makers can utilise existing market settings. For example, the following course of action may drive the required outcomes.
 - Increase the Market Price Cap (MPC) to incentivise greater contracting in lieu of an obligation to contract.
 - Decouple the Cumulative Price Threshold (CPT) and the MPC, whereby the CPT remains at or around its existing level to cap cumulative and therefore systemic risk but the MPC is significantly increased to maximise incentives within individual dispatch intervals.
 - Demand response would be better incentivised by an increased MPC to manage risks and supply costs. Notably, AEMO has recently paid well in excess of the MPC in order to secure demand response over the 2017/18 summer.
 - A higher MPC may better manage the challenge whereby the reliability standard of 0.002 unserved energy over time is being overshadowed by a view that the apparent reliability objective is that no load shedding should occur, notably over summer, and that AEMO operates the market so that no unserved energy arises.
 - Consider the removal or similar of semi-scheduled, non-synchronous generation from the calculation of the spot price, and thereby sharpen the incentive of dispatchable generation and storage. This can occur via use of an administered price for (zero short-run marginal cost) generation that isn't classified as dispatchable, or the creation of a separate spot price.
- ENGIE has significant concerns with the expanded role of the market operator and notes the industry, as 40 per cent shareholder, can provide AEMO with additional input on some of the challenges it is currently facing. While the AEMO is right to respond to real concerns in the market it is unclear the proposed solutions by the



ESB are justifiable and further time is warranted to consider the merits of each of the proposed changes to the NEM.

- ENGIE does not support elevating the role of long term forecasting to create obligations to be placed on retailers for reliability purposes.
- ENGIE has concerns about AEMO and other government participants playing a more active role in selecting capacity requirements within the context of the NEM. As stated above, a broader discussion on market sustainability may be warranted in this context.
- Should the ESB be minded to continue to pursue a form of mandatory contracting, then "dispatchability" should be defined as the ability to sell a financial derivative contract. These are primarily articulated in the form of swaps or cap contracts.
 - The NEM design presumes that financial derivatives and the spot market create an incentive for physical delivery of supply. ENGIE is not aware of any evidence to suggest financial derivatives positions have resulted in the non-delivery of supply throughout the history of the NEM. If there is a strong view that there is no correlation between financial derivatives and physical supply than the entire NEM design is being questioned. Given the NEM's ongoing success such a position needs to be clearly tested.
 - Tying dispatchability to financial derivatives incentivises all parties to take positions to offer and defend such contracts as they are a source of revenue. This enhances the incentives on the market to develop a product to firm intermittent generation (i.e. wind firming). ENGIE suggests this development is likely to emerge in the absence of the NEG in any case, but it also aligns with the intent of the NEG if implemented.
- Whether existing market arrangements are relied upon or a more fundamental change is implemented as a consequence of the NEG, ENGIE supports specific market reforms to better manage security of supply concerns. ENGIE notes that some arguments suggest security and not reliability of supply is in fact the critical issue in the NEM during the energy transition.
 - The ability to create separate markets for inertia and other services that were previously expected to be rewarded as part of the energy price should be investigated. ENGIE notes that Pelican Point Power Station is regularly directed on for reasons other than energy. ENGIE is very sympathetic to AEMO's concerns regarding security of supply, understands the rationale for such directions, and will continue to support AEMO in its role. Nonetheless, consideration should be given to whether a market signal can be created which will better address these issues.
 - Where in day signals for some services are not considered viable, then it may be worth evaluating the benefit of creating day ahead procured markets for such services. ENGIE does not support a day



ahead market as a general rule but appreciates that directing plant on for security reasons may be more manageable for AEMO on a day ahead basis. The use of day ahead ancillary services is not necessarily incompatible with the existing NEM design or financial markets.

- Any changes should be managed through the existing governance processes, notably the well understood AEMC rule change process and must have realistic implementation timeframes and transitional arrangements.

ENGIE trusts that the comments provided in this response are of assistance and welcomes further consultation on the NEG including its potential implementation in future years. Should you wish to discuss any aspects of this submission, please do not hesitate to contact me on, telephone, 03 9617 8415.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Jamie Lowe". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Jamie Lowe

Head of Regulation