MINERALS COUNCIL OF AUSTRALIA

ENERGY SECURITY BOARD
NATIONAL ENERGY GUARANTEE
DRAFT DETAILED CONSULTATION PAPER

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OVERVIEW

The Minerals Council of Australia (MCA) welcomes the opportunity to comment on the Energy Security Board's National Energy Guarantee Draft Detailed Design Consultation Document.

The MCA wants the National Energy Guarantee (NEG) to work. The reason is simple - reliable and affordable energy is central to our economy and to the mining sector.

The National Electricity Market (NEM) in Australia is facing serious challenges including the erosion of baseload generation capacity which is already adversely impacting Australia's industrial sector and households.

The announced close of Liddell Power Station will likely expose the fragility of the NSW power system. It is critical the NEG address this issue.

The MCA believes a technology neutral approach should be adopted for all low emissions energy sources where no one technology is favoured to the exclusion of others.

Any policy approach should aim to reduce energy costs in Australia and retain a focus on securing reliable lowest cost dispatchable energy supply that is available 24/7, while meeting emissions reduction targets.

The MCA recommends:

1. The 26-28 per cent emissions reduction target be embedded into legislation – this will provide the certainty required for businesses to invest in lowest cost dispatchable generation.
2. All state-based schemes be covered by the national target.
3. The government allow for the uncapped use of domestic and international offsets to minimise the cost of meeting Australia's climate change obligations.
4. Emissions intensive trade exposed industries be accorded the same treatment as under the Renewable Energy Target.
5. The requirement that generators must allocate all of their generation and associated emissions by the reporting and compliance date be
    a. removed or
    b. all generation accredited prior to the enactment of the NEG legislation be placed into the proposed unallocated pool.
6. Consideration be given to creating an opt-in arrangement for the large user reliability obligation instead of the proposed opt-out provision.
7. All eligible contracts for meeting the large user reliability obligation be grandfathered from the date the NEG legislation is passed.
8. Further work is required on whether the enactment of the reliability obligation will trigger regulatory change provisions within existing contracts.
9. The ESB consider benchmarking wholesale electricity prices based on the long run marginal cost of a portfolio of power generation technologies in Australia and comparable countries.
10. Consideration be given to the ACCC's recommendation government underwrite long-term energy contracts to secure private-sector investment in new low-cost power generation.

SPECIFIC COMMENTS

Emissions guarantee

MCA members are focused on the reducing emissions

The minerals industry acknowledges that sustained global action is required to reduce the risks of human induced climate change. The Australian minerals sector supports a measured transition to a low emissions global economy. This transition will require a policy framework encompassing:

- Australia's participation in global agreements such as the Paris Agreement that includes greenhouse gas emission reduction commitments from major emitting nations.
- A combination of short, medium and long term market-based policy measures that:
  - Provide for least cost abatement of greenhouse gas emissions
  - Maintain the international competitiveness of Australian industry
  - Minimise adverse social and economic impacts on households
  - Provide industry with policy certainty to make long term investments
- Substantial investment in a broad range of low emissions technologies and adaptation measures.

The Australian mining sector makes a significant socio-economic contribution to Australia. As a large producer and consumer of energy, the sector recognises it has an important role in addressing energy and climate change issues while delivering returns to our stakeholders, including employees, communities and shareholders.

The global transition to low emissions technologies – including solar, wind, batteries, gas, advanced coal and nuclear energy – depends on the metals and raw materials provided by the minerals sector.

Australia's Paris commitment of a 26-28 per cent target is challenging

The MCA supports Australia's Paris Climate Change Commitment of 26-28 per cent reduction in greenhouse emissions.

As the MCA has noted, Australia's Paris commitment of a 26-28 per cent reduction by 2030 of 2005 $CO_{2\text{-}e}$ emissions target represents one of the largest reductions in per capita emissions among G-20 nations.[1] In absolute terms, it is comparable to a range of other countries including Japan, New Zealand, Canada and the United States.

The structure of Australia's economy is very different from many developed economies which have effectively 'off-shored' their emissions to developing countries. By contrast, Australia plays an indispensable role in providing food, energy and resource security to some of the world's fastest growing economies in Asia.

With emissions counted where they are produced rather than consumed, this means Australia's emissions levels are higher, including in per capita terms than some post-industrial developed economies. Moreover Australia's economy and population will grow much faster than most developed countries.

As a result of these differences, Australia's transition costs will be higher than many comparable developed nations. This means policy options must take account of the critical need to maintain the international competitiveness of our export and import-competing industries.

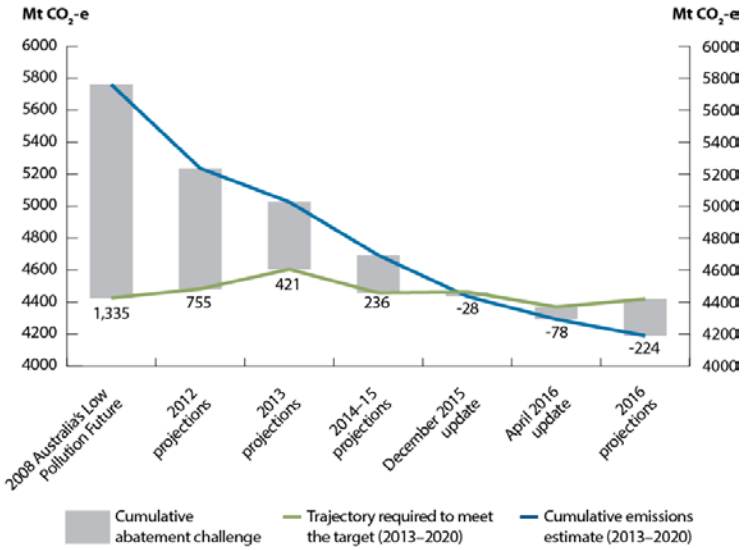
Unlike a number of other developed countries, Australia has an enviable track record of meeting climate change targets it has agreed to – something few other countries can claim. This has been

[1] Minerals Council of Australia, *Submission to the 2017 Review of Climate Change Policies*, May 2017.

seen in Australia beating its first Kyoto Target in 2008. Australia is also on track to beat its 2020 target by 294 million tonnes.[2]

Emission targets and abatement challenges do change

Chart 1: Change in the cumulative emissions reduction task over time - 2020 target



Source: Department of Environment and Energy, *Tracking Australia's emissions reduction targets*, December 2016

Chart 1 highlights how much 2020 emission projections have changed between 2008 and 2016. In 2008 the 2020 cumulative abatement challenge was 1,335 MT of $CO_{2\text{-}e}$ – that is the projected short fall in meeting Australia's 2020 target. By 2016 this had changed to a surplus of 224 MT $CO_{2\text{-}e}$.

A similar trend is already being observed in relation to the 2030 target. As the December 2017 projections state:

> Emissions in 2030 are projected to be 570 Mt CO2-e, a downward revision of 22 Mt CO2-e since the 2016 projections.
>
> The 2030 target will require: 868-934 Mt CO2-e in cumulative emissions reductions between 2021 and 2030 to meet the 26 per cent and 28 per cent targets respectively.
>
> This is a downwards revision of 122 Mt CO2-e since the 2016 projections.[3]

Put simply, Australia's projected 2030 emissions challenge improved by 11.6 to 12.3 per cent in 12 months.

This serves as a cautionary note to setting policies based on long term emission reduction targets - policies and responses need to be flexible so as to avoid even greater costs associated with locking in a policy mix designed to meet an uncertain target.

Embedding the 2030 target in legislation is critical

The proposed approach of embedding the 2030 target into legislation is welcome and supported.

Doing so is crucial for providing the certainty the sector is seeking with a 10 year horizon. While legislation can be changed, it would require parliamentary scrutiny.

Not embedding the target into legislation would undermine the certainty created by the NEG.

It would send a clear signal Australia's climate change policies are again the subject of partisan political debate. This would lead to even higher risk premiums being placed on new investment within the power sector.

[2] Department of Environment and Energy, *Australia's emissions projections 2017*, December 2017.
[3] ibid, p.3

Updating the 2031-2035 target in 2025 is also welcome. Again, this about providing certainty around the electricity sector's carbon budget.

A single national target is required

The Australian Government is the signatory to the Paris agreement, not the states. Having multiple state based targets creates greater uncertainty for investors.

Despite this, a number of states have indicated they will persist with more ambitious state-based targets. In this case, the Australian Government should include these under the national target – that is, any proposed state-based target should not be additional to the national approach.

Exemption of Emission Intensive Trade Exposed (EITE) activities

The proposed approach on exempting EITEs based on the current approach used with the Renewable Energy Target (RET) is appropriate.

Simplifying the current RET EITE process and the proposed version under the NEG is welcome. The RET process is well understood by industry, and alignment with it is a common-sense policy approach.

However, it should be noted the exemption from direct costs associated with the emissions target does not address the increase in wholesale prices driven by broader market events.

This is particularly relevant given the extent to which power prices have risen, and the prospect further closures of large low cost baseload plant may lead to higher prices.

It remains a key issue for MCA members – the need to address the erosion of baseload generation capacity which is already adversely impacting Australia's industrial sector and households.

Credible offsets should be allowed

The MCA supports the use of appropriate offsets – domestic and international –as a means of minimising the cost of meeting Australia's international obligations.

The MCA supports the proposed inclusion of Australian Carbon Credit Units (ACCUs) - taking into account the potential for 'double counting' as referenced in the Commonwealth Elements Paper.

Similarly, the MCA supports the Australian Government's intention to allow only those international units which are of an equivalent standard of ACCUs.

Proposed cap on offsets may not deliver benefits to consumers

The paper suggests placing restriction on the use of offsets in the power sector – 5 to 10 per cent – to meet the expected 2030 emission abatement challenge.

It remains unclear from an economic and investment perspective why this artificial constraint would enhance investor certainty or lead to lower power prices.

If, however, a cap is maintained, then the ESB may like to consider increasing the extent of banking and borrowing allowed under the emissions guarantee.

Proposed structure of the emissions registry is supported

The proposed Emissions Registry offers a workable means of addressing the challenge of incorporating emission reductions with associated compliance obligations.

While the MCA suggested in its March 2018 submission the Clean Energy Regulator may be better placed to operate the Registry, the MCA supports the ESB's proposal that it be operated by the Australian Energy Market Operator (AEMO).[4]

[4] Minerals Council of Australia, *Submission on the National Energy Guarantee Draft Design Consultation Paper*, 6 March 2018, p. 11.

Allocation of emissions within the registry – suggested approach

Minimising administration and transaction costs should be a key focus of AEMO's operation of the Registry. Similarly, the process should not provide a disincentive to those dispatchable generators with high emissions intensity who are vital to underpinning the reliability of the NEM.

The MCA is concerned the ESB's proposal that all generators 'will have an administrative requirement to allocate all generation and associated emissions by the reporting and compliance date' will increase administration and transaction costs.

Its practical effect will mean those generators with an emissions intensity higher than the NEM fleet average – that produced around 32.5 per cent of electricity produced in the NEM in 2016-17 – will potentially be placed in the untenable situation where they may need to pay retailers to allocate their emissions or be treated as non-compliant by the Australian Energy Regulator (AER).

This provision will increase costs and reduce incentives for investment in existing dispatchable generation. In that context, the MCA suggests:

- The requirement that generators must allocate all of their generation and associated emissions by the reporting and compliance date be removed or
- All generation accredited prior to the enactment of the NEG legislation be excluded from being able to be allocated by generators to retailers. This generation would instead go into the proposed unallocated pool. This would stimulate new low emission generation at the same time as limiting a windfall gain which may accrue to existing generation.

Reliability guarantee

Forecasting and updating the reliability requirement

The success of the National Energy Guarantee depends, in large part, on the accuracy of energy market forecasts. What has been proposed in the technical working paper provides a focus on accuracy and constant review.

A particular challenge will be the estimation of distributed energy sources. How these are dealt with, and particularly, the assumptions around availability will play an increasing role in the NEM and impact on the accuracy of forecasts.

Similarly, the role and scale of demand side responses needs to be better articulated and explained. At issue is the general failure to fully comprehend the impact of Hazelwood's close in 2017.

The decrease in supply that accompanied Hazelwood's close it also saw the activation of the Reliability and Emergency Reserve Trader on 30 November 2017 and 19 January 2018 where users were paid more than $50 million to reduce demand. Informal industry estimates suggest it cost as much as $60,000 MWh.[5]

Further, the notion demand-side responses are sustainable at scale need to be treated with caution.

The triggering of the reliability gap at T3 may need to be reconsidered if the intention is to bring new lowest cost generation available 24/7. Alternatives could include having a formal notification period at T5.

The proposal mentioned by the South Australian Government at the ESB's 2 July 2018 public consultation to effectively have the trigger operating from implementation may have merit. However, further detail and consultation is required.

[5] Ben Packham, Big firms get $50m in bid to keep lights on, *The Australian*,12 February 2018.

Liable entities - large user obligation

Underpinning the reliability obligation is a tacit recognition there is a relative lack of dispatchable output. MCA members already see this today in trying to contract for what is effectively baseload power – reliable power available 24/7.

The MCA appreciates the ESB's intent behind the large user reliability obligation proposal – to provide greater flexibility for large users to manage their power supply. However the large user reliability obligation, as proposed, creates a number of problems.

For most large users connected to the grid, it has been accepted the reliability associated with the power supply was the responsibility of the energy provider – this is what energy consumers paid for. But the large user obligation effectively transfers that risk from the energy provider to the energy consumer.

To address this risk, large users would have to invest in and maintain energy-related infrastructure and systems. This would require a degree of energy market expertise most large users currently do not have. Acquiring this would be neither easy nor cheap.

Providing the option for large users to opt out of the reliability obligation is, for many large users, not really an option.

It is acknowledged the ESB is considering changes to this approach. The MCA recommends the ESB considers the following:

- Instead of an opt-out approach, allow large users to opt-in. That is, large users would determine whether they accept the reliability obligation. This would be done via a formal notification from the large user to the retailer.
- Increase the threshold of the large user definition from 5MW. The MCA appreciates that any definition will create its own issues, however having a higher threshold would decrease the number of affected businesses.

Qualifying contracts

The ESB's proposal that only contracts entered into prior to the release of the High Level Design Document on 20 April 2018 would be eligible grandfathering for the purposes of compliance with the large user reliability guarantee.

While any date will effectively be arbitrary, the proposed date of 20 April 2018 should be changed. The NEG has undergone further refinements since then, including the release of Draft Detailed Design Consultation Paper. Further changes cannot be ruled out.

A better approach for the grandfathering of contracts could be from the date the NEG is agreed by the Council of Australian Governments' Energy Council or the date the enabling legislation is introduced into the South Australian Parliament.

Triggering regulatory clause provisions

MCA members are concerned whether the enactment of the reliability obligation will trigger regulatory change clauses which could re-open existing contracts.

This issue is central to the impact of the reliability obligation on large users. Further consideration of the likelihood and potential impact is required.

Baseload power will continue to be critical for Australia

The importance of baseload power generation cannot be overstated. As the Melbourne Energy Institute noted in its June 2017 report for the Independent Review into the Future Security of the

National Electricity Market (Finkel Review), the minimum level of synchronous generation capacity required for grid security is around 10,000 MW.[6]

That is, the type of electricity which can only come from large generators, usually 30MVA or larger in size.[7] In the Australian context that means coal, gas and hydro. Internationally, it also includes nuclear.

Baseload generators in Australia have also underpinned the provision of cheap, reliable and secure energy supplies. The close of Hazelwood power station in 2017 saw wholesale energy costs increase more than 80 per cent in Victoria.

The close of baseload power stations in Australia has coincided with an increase in electricity prices and a strong focus on ensuring reliability.

The close of Liddell Power Station and its replacement must be the focus

In the first six months of 2018 Liddell power station produced 4.8 TWh of baseload generation – that is available 24/7. Its removal will make a tight market for dispatchable power even tighter – something acknowledged by AEMO.

The MCA is concerned the close of Liddell Power Station will expose the fragility of the power supply system in NSW.

Related to this is the impact Liddell's close could have on wholesale energy market prices.

Future baseload prices in 2022 are already rising in Queensland and Victoria. However the biggest increase is in New South Wales, where future prices jump almost 37 per cent from December 2020 to June 2022.[8]

The close of Hazelwood offers a salutary reminder of what happens when large baseload plants close. It led to an 80 per cent increase in wholesale prices.

If Liddell is replaced with a combination of renewables firmed with diesel, small gas peaking and storage, the MCA is concerned this will be an expensive energy solution.

Consideration needs to be given to measures which drive investment in the lowest cost 24/7 dispatchable power. This should include upgrades at existing baseload power stations.

Complementary measures

Increasing transparency and accountability

Although outside the scope of the ESB's Draft Detailed Design Consultation Paper, the ESB may like to give consideration to developing, in the first instance, a benchmarking mechanism to increase transparency and accountability in relation to wholesale energy prices.

The aim would be to provide explicit focus on a key issue confronting Australian industry and households – high energy costs.

Such a benchmarking mechanism could be developed based on the long run marginal cost of a portfolio of energy sources available in Australia and among comparable countries.

Australian Competition and Consumer Commission Retail Electricity Pricing Inquiry

The Australian Competition and Consumer Commission's Retail Electricity Pricing Inquiry – Final Report Recommendation 4 that government underwrite long-term energy contracts to secure private investment in new low-cost power generation capable of meeting the needs of Australian industry should be considered.[9]

[6] Melbourne Energy Institute, *Power System Security Assessment of the future National Electricity Market*, June 2017, p. 47.
[7] Australian Energy Market Operator, *South Australia System Strength Assessment*, September 2017, p.14.
[8] https://www.asx.com.au/asx/markets/futuresPriceList.do?code=BN&type=FUTURE
[9] Australian Competition and Consumer Commission, *Retail Electricity Pricing Inquiry – Final Report*, June 2018, p. xvii.

As the MCA noted, the recommendation is ‘a welcome reality check’ to ‘address policy risks stopping investment in least cost power supplies which are available 24/7.’[10]

[10] MCA Media Release, ACCC proposes sensible approach to secure more affordable energy, , 11 July 2018