8 March 2018

Dr Kerry Schott
Independent Chair
Energy Security Board
By email: info@esb.org.au

National Energy Guarantee: Draft Design Consultation Paper

Dear Dr Schott,

The Property Council of Australia welcomes the opportunity to comment on the Energy Security Board's (ESB) Consultation Paper '*National Energy Guarantee: Draft consultation paper*' and provide feedback to the ESB and the Commonwealth on aspects of the draft design.

The Property Council is the peak body for owners and investors in Australia's $670 billion property investment industry. We represent owners, fund managers, superannuation trusts developers and investors across all four quadrants of property investments: debt, equity, public and private.

The property industry has traditionally been a more passive participant in energy markets. Rising wholesale energy costs and an absence of sound policy and market settings has resulted in unprecedented pressures on the costs and availability of electricity and gas for our members' operations, as well as hindering the ability of the sector to become more active participants in energy markets and make the transition to net zero emissions. This is consistent with the strong sustainability mandate of leading members, many having carbon neutral targets or net zero emissions targets before 2050.

The Property Council believes that the primary objective of energy markets should be to serve the long-term interests of the consumer as stated in the National Electricity Objective (NEO) and National Gas Objective (NGO). In the last decade, Australia has lost its advantage in reliable and competitively priced energy due to the ongoing and highly partisan debate on energy and climate change policy.

We support the objectives of the National Energy Guarantee (NEG) to depoliticise energy policy in Australia and to integrate energy and climate policy. This integrated approach should also be reflected in the NEO and NGO, which should be amended to include an objective to reduce emissions over time, in line with our international commitments.

We believe the NEG framework could deliver improvements in the reliability, affordability, and sustainability of the National Electricity Market (NEM), but its effectiveness will depend on its detailed design and, critically, the policies that are introduced to complement it. A coherent emissions reductions framework for the broader economy will be essential and will require effective collaboration with other key sectors, including the built environment.

The built environment holds many cost-effective opportunities for driving the transformation of the energy sector. Demand side drivers, such as those seeking to improve energy efficiency in buildings, encourage the development of sustainable utility infrastructure and will help support reliability requirements, reduce demand peaks, build resilience, and support longer term security across the NEM. According to the Australian Sustainable Built Environment Council, buildings could meet over half the National Energy Productivity Target (NEPP) and a quarter of the existing national emissions target with the right policies and incentives in place.[1]

Attached to this letter we include a submission with detailed responses to questions raised in the consultation paper. We also raise the following 5 key recommendations to both the Commonwealth government and the ESB to ensure the NEG will be effective:

1. Depoliticised energy policy agenda and Government transparency

At conclusion of the consultation period, the final design of the NEG must achieve bipartisan support and an agreement must be reached via the COAG Energy Council on complementary measures to be enacted by the states and territories to ensure a nationally consistent approach.

We support embedding the NEG into existing governance arrangements for the NEM with oversight from the ESB and a requirement for the Commonwealth to publicly report on progress against this agenda on an annual basis. This will help to ensure the ongoing policy agenda is depoliticised with a strong commitment to transparency from Government.

2. Increase demand side participation

As noted in the Paper, "*the demand-side is a key factor in driving the transformation of the energy sector*."[2] A secure and sustainable supply of electricity at the lowest cost is dependent on an appropriate balance of supply and demand policy. Supply and demand must be recognised as two sides of the same story within the energy policy framework.

Too often the focus is on building more supply side assets to solve the problems of the energy market when demand management presents an enormous opportunity for avoided supply side and network investment. While additional investment in supply side assets will be required, we would like to see greater emphasis on encouraging greater demand side participation as the front line of the fight to reduce overall costs, improve reliability and manage emissions. It is essential that the design of the NEG is revised to better

[1] ClimateWorks for Australian Sustainable Built Environment Council (ASBEC) 2016, Low Carbon, High Performance, 2016, p. 60.
[2] Energy Security Board consultation paper National Energy Guarantee: Draft consultation paper, p. 10.

accommodate demand-side approaches, or that the NEG is vitally linked to a more ambitious and appropriately funded *National Energy Productivity Plan.*

We strongly support the need to develop the NEG in concert with a demand response mechanism for the wholesale electricity market to ensure that any demand response products developed also qualify for compliance under the reliability requirement. We also strongly support retailers being able to buy dispatchable demand response contracts from independent aggregators to satisfy the reliability requirement. These contracts should be should be able to aggregate this demand response from any electricity consumer in the NEM, independently of that user's retailer.

3. Limit complexity and increase competition

To be effective, the NEG must encourage competition to put downward pressure on prices for consumers. We caution introducing additional undue complexity in contracting arrangements to meet the emissions requirement and reliability requirement would translate to higher costs for end consumers and would become a barrier to new market entrants and smaller retailers.

On the surface, it appears the NEG will require a comprehensive suite of documentation and procedures to be developed and implemented. This will necessitate increased staffing for the regulators as well as liable parties with obligations under the NEG. For example, the introduction of 5-minute settlement periods will require advice from AEMO at that frequency out to a fragmented pool of market participants to ensure reliability standards are met.

While we understand consideration of these issues must wait until a more developed framework emerges, we strongly urge the objective of price competitiveness for the consumer, as stated in the NEO, remains a core focus and avoids further entrenchment of the large vertically integrated gentailers' dominance.

4. Ensure large customers are not required to meet the reliability requirement

The reliability requirement of the NEG should not require large commercial and industrial energy users who use a retailer as an intermediary to respond. These customers do not have the expertise required to respond to such a requirement and if forced to do so it would have a significant impact on these customers' risk profile and cost, without evidence of a strong NEM benefit such as a material improvement in system reliability.

Large consumers have borne the cost pressures resulting from policy failure and are fundamentally ill-equipped to respond to the procedural and administrative requirements to be imposed on liable entities under the NEG. For the few customers who may have such expertise, provision could be made to respond voluntarily. The ESB does not provide a clear definition of large customers and notes, "*Any process to give effect to this would either need to* *identify customers on spot pass-through arrangements with retailers; or simply 'deem' customers above a certain size to comply with the requirement.*[3]"

The ESB notes the legal and cost considerations in imposing the NEG requirement on large customers, and we note the complexity of such an arrangement would be far more complicated that limiting the obligation to retailers. We believe that large customers who contract with retailers who are already liable under the NEG should not have a direct responsibility to meet the reliability requirement.

5. Encourage voluntary action to reduce emissions

The Commonwealth should commit to a review of carbon accounting across existing Commonwealth policies, including the NEG, and the establishment of a common framework that dictates how generators, retailers and consumers must calculate and report emissions, both for the purposes of compliance with legislation and making consumer claims.

Essential to the success of the NEG is a well-defined framework for participants in the voluntary secondary market to encourage strong consumer action on emissions reduction. The leaders within Australia's property industry have set their own ambitious emissions reduction targets, but without clarity on how consumer claims for scope 2 emissions reduction would be treated under the NEG, this is likely to stall investment from some of Australia's most progressive businesses.

The Renewable Energy Target (RET) legislation provides no legal framework for participants in the voluntary secondary market. It has evolved to operate under the assumption that Large Generation Certificates (LGCs) are "fully aggregated", encompassing all social environmental and non-energy attributes of the renewable energy that resulted in their creation. This results in some perverse outcomes and disincentivises investment in renewable energy by businesses that want to make claims on how they're reducing emissions.

In the current environment, if a building owner wants to invest in rooftop solar PV to reduce the emissions from the building's operation and make a public claim that the energy consumed from the array has zero emissions, the LGCs produced from the installation must be voluntarily retired. This means they must forego the financial incentive the LGCs provide as the assumption has been made that the emissions attribute of the energy is traded with the certificate, despite the fact the certificates are retired by retailers against an energy target and are not counted as contributing to a national emissions reduction target.

This is not the case in other countries around the world like the UK which have evolved strong voluntary consumer markets by separating the energy and emissions components from a generation source and allow trading the components in separate markets.

There are inconsistencies in carbon accounting within different Commonwealth policies and a review is needed to establish a clear framework for consumer claims under Commonwealth

[3] Energy Security Board consultation paper National Energy Guarantee: Draft consultation paper, p. 41.

and state government policies. Given the end goal is net-zero emissions for the electricity sector, previously raised issues around additionality become less and less important as the grid decarbonises, and in the short term, maintaining the current position will only hinder businesses that want to make that transition faster by making them pay a premium.

Thank you for the opportunity to provide comments on the NEG consultation paper. We would be very keen to discuss the issues raised in this submission in person. Please do not hesitate to contact Frankie Muskovic, our Policy Manager for Sustainability and Regulatory Affairs at fmuskovic@propertycouncil.com.au to arrange a meeting.

Yours sincerely

Ken Morrison
Chief Executive

Detailed Responses to Consultation Paper Questions

Emissions requirement: Commonwealth Government design elements

Question: Stakeholder views are sought on options for setting the emissions targets under the Guarantee

The Property Council:

- believes the emissions requirement needs to be set at a level that is credibly in line with Australia's commitment to the Paris Agreement, which is to limit greenhouse gas emissions so that global warming is kept below 2 degrees Celsius with a stretch goal of keeping it below 1.5 degrees Celsius. At a minimum this requires Australia to reach net zero emissions by 2050. We therefore recommend a long-term emissions reduction target for the electricity sector is set for net zero emissions by 2050
- recommends a trajectory of emissions reduction in the electricity sector out to 2050 is forecast consistent with the above point, and interim targets are set working backwards from there. Based on recent modelling by CSIRO, the existing commitment to reduce emissions by 26 to 28 per cent by 2030 would likely require the emissions requirement to ensure that at least 40 per cent of generation came from renewable sources by 2030[4]
- agrees with the Commonwealth approach of expressing the emissions target as a trajectory of annual average emissions per MWh levels for retailers in the NEM.

Question: Stakeholder views are sought on:

- ***Whether, and in what circumstances, electricity emission targets already set should be adjusted.***
- ***The process for making any such adjustments to electricity emissions targets.***

The Property Council:

- supports not adjusting the electricity emissions targets to account for changes in electricity demand with any change being considered in the context of setting future electricity emission targets
- supports not adjusting a 5-year emissions reduction target once in place. There needs to be sufficient certainty provided for investors to contract for new generation
- supports the ability for a long-term emissions trajectory to be adjusted at agreed review points to allow for faster decarbonisation based on changing economic viability of generation technologies

[4] CSIRO 2017 Low Emissions Technology Roadmap

Question: Stakeholder views are sought on the proposed timing for updating the electricity emissions targets, including a five-year notice period

The Property Council:

- agrees with the target setting to initially be 10 years and then subsequently 5-year periods synchronised with the timelines required for updating commitments under the Paris Agreement
- agrees with the concept of locking in 5-year targets (where emissions reduction targets will not change once put in place) while forecasting the next proposed 5-year milestone further down the track. These forecasts should have the ability to be adjusted in line with the recommendation to revisit the ambition of the long-term trajectory towards net zero emissions. This would ensure industry has good visibility over at least the next 10 years in the trajectory. A 5-year planning cycle alone would not be long enough to properly incentivise investment.

Question: Stakeholder views are sought on the proposed approach to setting the electricity emissions targets under the Guarantee and interaction with state renewable energy schemes.

The Property Council:

- strongly supports a nationally coordinated and consistent approach to reducing emissions in the electricity sector
- agrees with setting a single annual electricity emissions target under the Guarantee that will apply across all jurisdictions in the NEM
- requests a review of the robustness of carbon accounting logic and principles as they relate renewable energy certificates and contracts for emission reduction under the proposed NEG framework and state renewable energy schemes.

Question: Stakeholder views are sought on issues to be addressed in exempting EITE activities from the emissions requirement of the Guarantee

The Property Council has no objection to the exemption of EITE activities from the emissions requirement, consistent with the approach established under the Renewable Energy (Electricity) Act 2000. We note that energy is a major component of the cost of steel, cement, aluminium and other products used in the construction industry and if EITE activities were to be included this would likely result in increased construction costs. Based on modelling done by Davis Langdon in 2011[5] to estimate the impact of a carbon price on construction costs, they found that the provision of industry assistance would limit the increase in total build costs to approximately 0.5 percent.

[5] Davis Langdon 2011 Carbon Price on Construction Costs

Question: Stakeholder views are sought on whether retailers should be allowed to use external offsets to meet a proportion of their emissions requirement. In particular, views are sought on:

- ***Whether there is a strong rationale for the use for offsets within the Guarantee***
- ***The impact allowing offsets would have on investment under the Guarantee***
- ***If offsets were to be used to help achieve compliance with the emissions requirement, what would be an appropriate limit for their use?***

The Property Council:

- does not support the use of external offsets by retailers to meet any portion of their emissions requirement. We support the inclusion of other flexible compliance options such as carrying forward overachievement (section 3.4.1) and deferring compliance (section 3.4.2) and question the rationale for the use of offsets with other flexible compliance options available, as is currently the case under the RET
- believes the intention of the NEG is to provide an appropriate signal to the Australian electricity sector for investment in new generation and guide the transition of the sector towards a long-term emissions reduction target. In that context, the use of external offsets will undermine the aim of the policy and act to divert funds outside Australia that would otherwise be used to fund investment in new generation domestically.

Emissions Requirement: Energy Security Board design elements

Question: What are stakeholders' views on how a retailer's emissions should be determined?

The Property Council:

- requests a review of carbon accounting across existing Commonwealth policies, including the NEG, and the establishment of a common framework that dictates how generators, retailers and consumers must calculate and report emissions, both for the purposes of compliance with legislation and making consumer claims
- requests clarification on how retailers' emissions factors would interact with long-used methods for carbon accounting across the NEM i.e. the state-based emissions factors calculated using scope 1 emissions factors from large generators
- requests a simple mechanism be developed to enable price discovery by consumers. There is a strong desire for accuracy and transparency, but we understand the retailers' emissions factors will be dynamic.

Question: Should the emissions requirement allow for unlimited carry-over of overachievement or specify limits on the carry-over of overachievement?

Question: What are stakeholders' views on the deferral of compliance?

The Property Council supports the inclusion of other flexible compliance options such as carrying forward overachievement (section 3.4.1) and deferring compliance (section 3.4.2) and question the rationale for the use of offsets with other flexible compliance options available, as is currently the case under the RET.

Question: What are stakeholder views on the interaction between the emissions requirement of the Guarantee and voluntary programs such as GreenPower?

Voluntary behaviour to reduce emissions should be encouraged and participation in voluntary programs such as GreenPower, which are currently additional to the RET.

The role of voluntary schemes in the NEG requires further consideration and should be looked at in the context of a long-term trajectory towards net-zero emissions for the electricity sector. The rationale for requiring additionality reduces the closer we get to 100% renewable energy, and given the inconsistencies that exist in carbon accounting across Commonwealth and state-level policies, we believe this should be the subject of expert review, in tandem with further development of the NEG.

Australia needs a common framework that dictates how generators, retailers and consumers must calculate and report emissions, both for the purposes of compliance with legislation and a separate process governing companies making consumer claims. This will become ever more important as the contribution of businesses with their own sustainability agendas is expected to play a bigger role in driving decarbonisation.

As stated previously in our submission, the RET legislation does not address LGCs from the perspective of their use for scope 2 emissions reduction for consumer claims. As such, there is no legal framework that addresses the use of LGCs for achieving carbon neutrality claims. However, due to demand from the participants in the voluntary greenhouse market, particularly those that purchased GreenPower, the voluntary LGC market has evolved to operate under the *assumption* that LGCs are 'fully aggregated', encompassing all social environmental and non-energy attributes of the renewable energy that resulted in their creation.

This has meant that companies can only make consumer carbon emissions reduction claims if the LGCs have been voluntarily retired, meaning that companies who want to make a carbon claim must sacrifice the financial value associated with the LGCs. There is currently no ability to make voluntary carbon claims about the renewable energy that contributes to the RET.

As the market for renewables grows the property industry anticipates greater demand from customers to purchase renewable energy at a price that is competitive with or lower than the cost of fossil fuel generated energy. A mechanism must be found to enable consumer claims on renewable energy which contribute to the RET and NEG targets. One way to address this could be to have the carbon accounting associated with liability under the NEG governed by one "certificate" with attributes that only relate to the NEG, and a separate carbon certificate should operate for non-regulated consumer carbon claims. In this scenario, only the NEG certificates would be counted toward the national emissions reduction target; the corporate carbon claim certificates would be confined to the relationship between companies making the claim and their customers.

Question: What are stakeholders' views on the need for a compliance registry? What are stakeholders' views on its design?

Question: Should any of the data in the registry be made publicly available?

Question: Is there a need for retailers or generators to report contract pricing information as part of the input into the registry?

The Property Council supports a compliance registry where key information, including retailer emissions and price are publicly available and simply presented. The provision of such a registry must consider the balance of accuracy of the information and certainty for customers accessing it; there's no point providing a registry where the retailers' emissions and price data changes at 5-minute intervals, so consideration of a longer-term average could be looked at.

Question: What are stakeholder views on how the Guarantee may impact on competitive market?

Given the rapidly evolving pace of technological change, a competitive market will be crucial to drive innovation and deliver new products and solutions. The built environment presents enormous opportunities for distributed generation that will provide additional baseload generation, reduce peak demand, build resilience, and support longer term security across the NEM. That said, many rooftop solar or other onsite generation projects do not go ahead due to several regulatory and financial barriers. A building owner does not get a commercial return for any excess energy exported to the grid or is unable to virtual net-meter and offset their building portfolio's generation and consumption.

There should be potential for distributed generators to contract with retailers liable under the NEG to fulfil their emissions requirement. This would mitigate the amount of network infrastructure required over time, however we are concerned that under the current drafting of the NEG, retailers will have no incentive to contract with distributed generators but will instead internalise their emissions requirement and entrench the position of the existing vertically integrated gentailers. While there would be additional administration to contract with a number of distributed generators, this does not account for the considerable network savings that would be achieved from avoided infrastructure. We strongly recommend this is considered in the detailed development of the NEG and incentives are put in place to encourage contracting with distributed generators.

Reliability Requirement

Question: Should the existing ESoO and MTPASA forecasting processes be adapted for determining the gap, or should a separate bespoke process be developed?

The Property Council supports the option which is most cost effective.

Question: Should AEMO be able to determine assumptions independently or should responsibility for the accuracy of assumptions be placed on the market participant?

AEMO should have this responsibility.

Question: How frequently should the forecast be updated?

Monthly to quarterly.

Question: How should C&I load be treated?

As stated earlier in our submission, this should be managed by large customers' retailers who are liable under the NEG, with an option for customers to do so directly if they choose.

Question: What are stakeholder views on extending the reliability requirement to large energy users that are not market customers?

The reliability requirement of the NEG should not require large commercial and industrial energy users who use a retailer as an intermediary to respond. These customers do not have the expertise required to respond to such a requirement and if forced to do so it would have a significant impact on these customers' risk profile and cost. For the few customers who may have such expertise, provision could be made so to respond voluntarily.

Question: What are stakeholder views on how the Guarantee may impact on competitive markets?

The Property Council strongly supports the development of the NEG in concert with the development of a demand response mechanism for the wholesale electricity market to ensure that any demand response products developed also qualify for compliance under the Reliability Guarantee. Demand response should have the same freedom to bid into the market as a peaking generator. We look forward to the current AEMC Reliability Frameworks Review to bring forward the required changes.

We also strongly support retailers being able to buy dispatchable demand response contracts from independent aggregators to satisfy the reliability requirement. These contracts should be should be able to aggregate this demand response from any electricity consumer in the NEM, independently of that user's retailer.