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Dr Kerry Schott
Independent Chair
Energy Security Board
C/o COAG Energy Council Secretariat
Department of the Environment and Energy
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Lodged online to: info@esb.org.au

7 March 2018

Dear Dr Schott,

RE: National Energy Guarantee Draft Design Consultation Paper, 15 February 2018

Thank you for the opportunity to comment on the Energy Security Board's *National Energy Guarantee Draft Design Consultation Paper, 15 February 2018.* As the peak body for the health and community services sector in South Australia, the South Australian Council of Social Service (SACOSS) has an established history of interest, engagement and provision of proposed advice on the necessary market mechanisms for and regulation of essential services. Our research shows that the cost of basic necessities like electricity impacts greatly and disproportionately on vulnerable people. Our advocacy is informed by our members and direct consultations with consumers and other consumer organisations: organisations and individuals who witness and experience these impacts in our community.

The lack of aligned climate and energy policy in recent years has led to the pursuit and implementation of disjointed goals, resulting in an electricity market that threatens security and reliability expectations, with escalating costs that threaten the affordability for households, and the viability of many businesses and the broader economy. SACOSS supports the intent of the National Energy Guarantee to coordinate energy reliability and emission reduction targets, while at the same time improving affordability through a more stable policy and investment environment.

To achieve its goals the NEG must be carefully designed and build on the existing market features rather than pursuing an entirely different arrangement that would be detrimental to achieving a competitive market that incentivises timely investment in new generation.

Given the limited time available in providing feedback on the full range of questions posed in the consultation paper, SACOSS has addressed the issues it sees as important to the development of a workable NEG, with particular reference to South Australia.

3.7.1 and 5.11.1: Competitive Markets

The ESB has previously recognised the unique electricity market situation in South Australia relative to other NEM regions in its November 2017 report[1] where it highlighted the concentration of generation ownership and the relatively small number of vertically integrated participants dominating the retail market. A lack of competition and shortage of wholesale contract providers has resulted in market prices being consistently higher than other NEM regions.

Ideally, the NEG design would seek to improve competition in South Australia and encourage investment in new dispatchable generation sources. A well-designed reliability obligation, requiring retailers to contract or

[1] *Energy Security Board Advice: The National Energy Guarantee, 20 November 2017*

invest in eligible dispatchable resources well in advance of the forecast shortfall in capacity will improve the reliability and security of the electricity system. The limited notice period (of less than one year) provided prior to the closure of the Northern Power Station in May 2016 did not allow for an adequate investment response in new dispatchable capacity. Mandating a market response in such a situation via the reliability guarantee is a worthy measure.

SACOSS has concerns that the implementation of the NEG will initially reduce contract market liquidity in the NEM. South Australia already has a low level of exchange trading activity, as evidenced by the low level of open positions and trading volume on the ASX Futures exchange, and inactivity in OTC contracts. Introducing additional complexity and bespoke terms and conditions to contracts (for both dispatchability and emission obligations) is likely to result in even lower trading activity and increase the reliance on an already concentrated number of participants providing wholesale contracts. Prices would inevitably rise due to reduced competition.

Though the consultation paper states that further consideration cannot be given to address market concentration issues until the design of the NEG is further developed, SACOSS believes this should be a key focus for the ESB in formulating the design parameters of the NEG, and that the mechanisms suggested by the ESB in limiting further market concentration in South Australia, including restrictions on generation ownership should be integrated into the NEG design.

Emission Requirement

3.3: Contracting and Emissions

SACOSS believes that assigning an actual or deemed emission intensity to contracts held by retailers will prove to be a complex task. A compliance registry for retailers and generators will be required to link contracts specifying the generation source with an actual emission intensity. SACOSS is concerned about the additional cost of compliance with registry requirements, and the flow on to increased cost to consumers. Though information reported by generators under the National Greenhouse and Energy Reporting Scheme, or metered generation and consumption data settled by AEMO may reduce the burden of reporting in the contract registry, reporting and validation of contract positions introduces an additional compliance obligation.

SACOSS believes that punitive measures should not be assigned to retailers who either do not specify a generation source in contracts, or those who have a degree of spot exposure, as this would result in an undesirable outcome in influencing how retailers are managing their portfolio risk and reliability guarantee obligations. Measurement and compliance under the emission and reliability obligations should be managed separately.

For contracts not specifying a level of emissions or emission source (i.e. futures contracts), a deemed level of emissions will need to be assigned. Rather than assigning this on the basis of the emissions of those generators that sold this type of contract in the previous year as proposed in the consultation paper, SACOSS believes all contracts of a particular type should be deemed to have the same emissions level. With contract volumes that vary on a half-hourly basis, establishing a deemed emission level promises to be an extremely complex task.

Unhedged load should also be assigned a deemed emission level. Whether this is able to be calculated reliably taking into account changing generator dispatch, contract positions (for generators and retailers), and inter-regional flows remains to be seen.

3.4: Flexible Compliance Options

A degree of flexibility is supported by SACOSS for retailers in achieving compliance with the emission requirement under the NEG.

SACOSS agrees that banking of over-achievement be allowed (as it currently for retailers liable under the Renewable Energy Target). It is not necessary to restrict the level of over-achievement, as trading of over-achievement would likely emerge if there is demand for it to enable participants who are under-achieving their emission obligation to meet compliance requirements.

Deferral of a small proportion of a retailer's annual compliance is recommended to allow for variation in intermittent generation output and changes in thermal generator emission intensity. SACOSS supports a 5-10% limit on a retailer's emission obligation to maintain scheme integrity.

The use of off-sets under the NEG is not supported by SACOSS as the emission requirement should be designed to encourage investment in new zero or low emission generation in Australia.

3.7.2: Jurisdictional Considerations

The interaction between the emission requirement under the NEG and State based emission trading schemes is noted in the consultation paper. SACOSS agrees in principle with the position proposed by the Commonwealth Government (in Section 4.2.5 of the consultation paper) that retailers contracting with generators eligible under the Renewable Energy Target and State based renewable energy schemes would be able to count their generation towards meeting emissions requirements under the NEG.

Emission Requirement: Commonwealth Government Design Elements

4.2: Setting the Electricity Emissions Target and Review Processes

SACOSS supports the Commonwealth Government's proposal to express the emission intensity target for the electricity sector as a trajectory of annual average emissions per MWh levels (referred to as 'electricity emissions targets') for retailers in the NEM. This approach is appropriate as it sets a fixed annual target for the level of emissions per MWh for retailers, with actual emissions dependent on total electricity consumption. Regardless of whether demand is higher or lower than expected, the level of emissions per MWh retailers must achieve would remain unchanged, allowing for the transition to lower-emissions generation in the sector to occur at a stable pace.

SACOSS agrees that electricity emission targets should not be updated to account for changes between forecast and actual demand and that these variations be applied to determining future emission targets to preserve investment certainty. Changes to the target should be made with at least five years notice, and in accordance with Australia's obligations under the Paris Agreement.

Reliability Requirement

5.3: Forecasting the Reliability Gap

SACOSS believes forecasting the reliability gap should occur on a long-term timeframe of 10 years, updated annually as per established AEMO forecasting processes to allow for a long-term view of regional supply requirements. Updating of the forecast should also occur if there is a significant market change or the announcement of a major generator retirement.

5.5: Triggering the Requirement

SACOSS supports a longer-term trigger of three to five years notice in triggering the reliability obligation, recognising that electricity sector investment can take significant time to develop and implement. A longer-term trigger will enable investment to occur in a timely manner.

5.6: Qualifying Instruments

The consultation paper describes the range of contracts and risk management products currently available to retailers in managing their retail portfolio risk. SACOSS believes all current contract forms (apart from weather derivatives) should be considered eligible for the purposes of the reliability requirement to preserve market liquidity and competition. Other eligible contract forms may develop over time, however these will take time to materialise and be actively traded.

Financial contracts not specifying a physical generation source should not be any less valid than those that do in meeting the reliability obligation. The contract market underpinning NEM trading is largely financial, however, these contracts influence generator behaviour sufficiently to provide the necessary dispatch response (whether they be swap or cap contracts). SACOSS cautions against linking a contract's actual level of dispatched electricity in determining compliance with the reliability obligation.

SACOSS supports the eligibility of both supply and demand-side options in qualifying as eligible dispatchable sources under the reliability obligation. Their eligibility must consider the unique availability, reliability, and duration characteristics of the dispatchable source.

5.7.1: What is allocated?

SACOSS believes there is a role for AEMO in being an intermediary in managing supply and demand requirements in meeting the reliability gap via a book build process. In a region such as South Australia, this would place less reliance on incumbent retailers making investment on their own accord and incentivises the participation of new entrants. A book build process would also provide transparent price and compliance cost outcomes, and clear path for retailers with a demand for dispatchability contracts.

5.7.2: Should the Requirement be Expressed as a Total or an Increment?

SACOSS prefers the percentage of peak load allocation of the reliability requirement be made on the basis of the shortfall or "gap" rather than total supply to avoid the shortfall in a region.

Retailers should continue to have the ability to manage their retail positions as they see fit and not be forced to contract to 100% of peak load requirements which may result in unnecessary costs being incurred when a reliability gap is triggered. The timeframe in which a reliability obligation may be triggered (i.e. three to five years) is designed to incentivise new dispatchable resources, while retailers generally work on a one to three-year horizon to hedge retail portfolio requirements with existing sources. Retailers would however need to demonstrate that the contracts entered into to close the gap were "additional" and linked to new sources of dispatchable supply.

5.9: Procurer of Last Resort

AEMO's role in procuring reliability requirements (in the event that retailers fail to provide it either independently or via a book build process) should be seen as an absolute last resort in the same fashion as the Reliability and Emergency Reserve Trader (RERT).

Retailers who are not compliant with their reliability obligations should face civil penalties and be required to fund their share of AEMO's procurement costs. A strict compliance regime, supported by an AEMO administered book build process will increase the likelihood of new dispatchable supply being developed in a timely manner to meet reliability requirements.

We thank you in advance for consideration of our comments. If you have any questions relating to the above, please contact SACOSS Senior Policy Officer, Jo De Silva on (08) 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

Ross Womersley, Chief Executive Officer