

The Australian Industry Group

What's the new National Energy Guarantee all about?

The National Electricity Market has seen steep price increases over the past year, partly because the retirement of old generators has left supply tight, and partly because the tighter market is more exposed to the rising fuel costs of gas-fired generators. Getting more electricity supply is a critical part of lowering prices, but deep uncertainty over the future climate policy treatment of the electricity sector has been holding back any investment outside the current Renewable Energy Target.

The Federal Government has now accepted [a recommendation from the Energy Security Board](#) as its preferred solution: the National Energy Guarantee. This brief sets out what the NEG is and what may happen next. Information and analysis continues to emerge and Ai Group will keep updating our assessment.

Substance of the policy

The National Energy Guarantee (NEG) framework imposes two new obligations on electricity retailers and any users large enough to buy directly in the wholesale electricity market:

1. *Reliability guarantee*: to hold forward contracts with dispatchable resources that cover a predetermined percentage of their forecast peak load.
 - a. A NEM-wide dispatchability target set by the Reliability Panel will be translated by AEMO into targets specific to the needs of State regions of the market.
 - b. This is a different way of implementing the Finkel Generator Reliability Obligation – it's broader as it is not limited to new builds, and it impacts retailers not generators.
 - c. Retailers could meet this by contracting with a variety of dispatchable sources like coal, gas, hydro, solar thermal, pumped hydro, battery systems, demand response or wind and solar PV systems with firming arrangements (on site batteries, backup generators, more).
 - d. What retailers have to ensure is *not* that a certain share of energy is actually delivered from dispatchable resources, but that they have contracts to ensure they can call on dispatchable resources if they need them. To give an oversimplified example, a small retailer might wind up purchasing most of its energy from a wind farm while paying a gas plant to be on call.
 - e. Note dispatchability means 'able to operate on demand' and does not necessarily mean reliability – gas and coal plants can and do fall over when something goes awry.

- f. Nearly all electricity retailers already buy most of their electricity from dispatchable sources and it is not clear whether or when this rule will bite, but it is likely to be immediately significant in SA.
2. *Emissions guarantee*: to ensure that the overall mix of electricity they buy meets an emissions intensity goal (yet to be set, but envisaged as consistent with our Paris 2030 commitment).
- a. They have full flexibility on buying electricity to meet this from any source, so it is technology neutral.
 - b. There are no visible credits, certificates or explicit carbon prices. Electricity retailers will make their own arrangements with generators or their own assets to comply.
 - c. The Energy Security Board suggests that Australian carbon credit units (ACCUs) and international units *could* be permitted to meet a proportion of the retailer's guarantee and banking and borrowing across the compliance period would be allowed to a certain level. There have been no announced government decisions on this front.
 - d. The targeted intensity goal would be set to at least 2030, with regular review and refinement by electricity market regulators (but not a lot of detail on this process yet).
 - e. Emissions Intensive Trade Exposed industries are said to be exempt from this obligation, just as they are from the RET. However, note that:
 - i. The exemption applies to the emissions intensity guarantee, not the reliability guarantee;
 - ii. It is simple to exempt EITEs large enough to buy directly from the wholesale electricity market – the intensity guarantee simply doesn't apply.
 - iii. It is not yet clear how EITEs that buy power from retailers will be exempted – how will retailers determine a portion of their costs to exempt EITEs from? How will EITEs know if they are being fully exempted?
 - iv. Any exemption will ultimately shift some costs to other energy users.

Both elements of the NEG would allow retailers to make 'secondary exchanges' with each other to help meet their obligations. For example, if one retailer is set to overperform against reliability and underperform on emissions, and another is in the reverse situation, they could contract to even out their performance and minimise compliance costs.

Compliance will involve some flexibility to remedy shortfalls but would be ultimately enforced by the threat that a retailer will be deregistered and put out of business. This is a big stick!

Overall the combined scheme is comparable to previous emissions intensity scheme and reliability obligation concepts, but applied to retailers and with all certificate/crediting elements left for the private sector to develop and administer itself. It has the potential to be a workable and reasonably efficient framework, with the following caveats:

- Bipartisan and State support is needed before this will lead to investment;
- A sensible process for future review and deepening of the emissions intensity target will be critical to investability and political support; and
- An awful lot of detail needs to be developed and understood.

Process

The Government would like to commence the reliability guarantee from 2019 and the emissions guarantee from 2020.

Both parts of the NEG would need to be agreed with COAG and implemented through the National Electricity Law and subordinate rules. It may be that no Commonwealth legislation or regulation is required (with the possible exception of the level of the national emissions target), but intergovernmental agreement certainly will be.

The Commonwealth will take this proposal to COAG Energy Council in November and task AEMC to undertake further modelling and analysis for COAG. There will be stakeholder consultation. The current Renewable Energy Target would continue unchanged, with the large-scale target topping out in 2020, certificate issuance ending in 2030, and the small-scale target continuing its slow phaseout to 2030.

Politics

To be enacted at all the scheme needs the agreement of the States. It is not yet clear if this will be forthcoming. States could keep their own policies (such as Victoria's contracts for difference) if the new scheme is enacted. However, State-based policies that led to a higher level of variable renewables would also lead to higher costs for energy users in that State under the reliability guarantee.

To motivate investment the scheme also needs to maintain continued support from the Coalition and Labor at the federal level. The ALP has repeatedly signaled they would be open to supporting any workable policy for the sake of spurring investment, but they are also wary of giving too much ground.

The scheme has so far attracted wide support within the Federal Government, including from sections critical of renewable energy and emissions reduction. It is not clear if this support will remain as further analysis and stakeholder reactions develop.

There is a very delicate political balancing act for the Government in convincing the ALP and States to support the scheme while maintaining internal unity. Decisions around setting the emissions reduction ambition of the scheme – and processes for altering that ambition over time – will be fraught but critical to achieving agreement across parties and levels of government.

What will this do to my energy prices?

Some very rosy figures have been bandied about already for expected electricity price reductions and expected renewables/coal/gas generation mix. These are extremely preliminary and further modelling will be done. These estimates in any event should not be taken too seriously; the generation mix results will mostly reflect technology cost assumptions not scheme design, and price impacts mostly reflect the choice of comparison scenario.

Wholesale electricity price futures already decline to 2020 (see below), largely reflecting the expectation of more supply driven into the market by the current Renewable Energy Target.

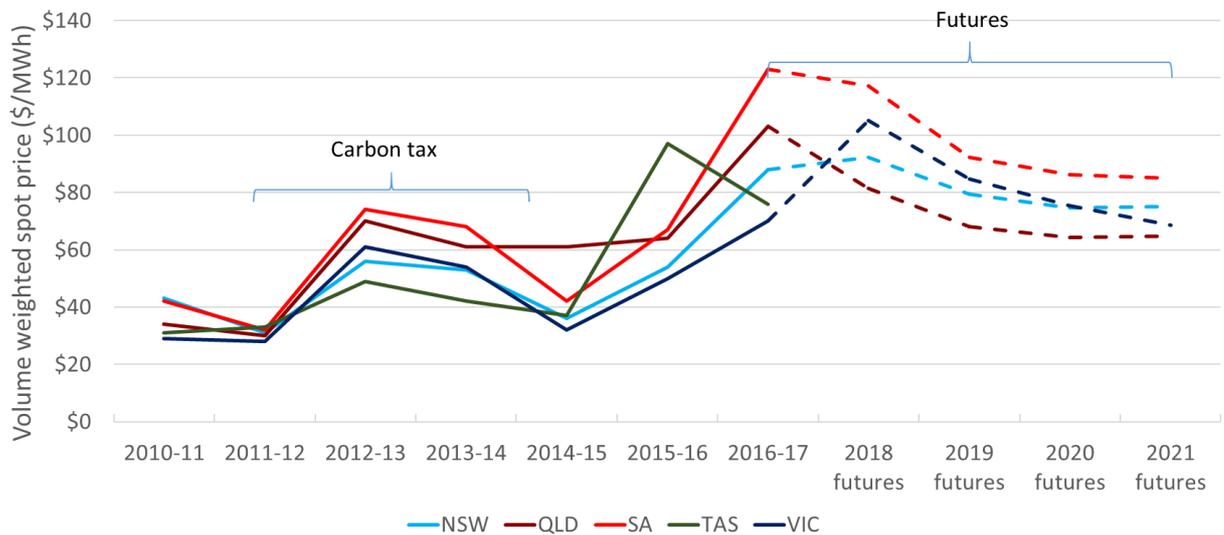


Figure 1 Wholesale electricity prices, historical and futures

It will be some time before the market has enough information to reflect the NEG. Broadly the impacts will be of two kinds:

- Both the Reliability Guarantee and the Emissions Guarantee will have compliance costs for retailers, which they will pass through to customers. The amount of flexibility involved helps ensure these costs are as low as possible for the levels of reliability and emissions intensity targeted.
- If the NEG is seen as a politically durable solution it should unlock substantial investment in electricity generation and reliability resources. That additional supply should put downward pressure on wholesale and retail electricity prices.

The overall direction of electricity prices will probably depend more on cost reductions for renewables and firming resources, and trends in gas prices, than on the nuances of the electricity policy – once there is sufficient confidence in policy to invest in anything.

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