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NATIONAL ENERGY GUARANTEE - DRAFT DETAILED DESIGN FOR CONSULTATION – COMMONWEALTH ELEMENTS

Thank you for the opportunity to provide a submission on the consultation paper: *National Energy Guarantee - Draft Detailed Design for Consultation – Commonwealth Elements*. This submission is made on behalf of Australia's aluminium industry, and covers the significant electricity use and economic activity associated with aluminium smelters and alumina refineries connected to the National Electricity Market (NEM).

Context

Before addressing some of the specific issues and questions from the Consultation Paper, the aluminium industry emphasises some important points of context:

- Australia's world class conventional and renewable resources should be the basis for internationally competitive energy pricing for Australian industry.
- Delivering material improvements in electricity pricing will require more than the National Energy Guarantee (Guarantee). Importantly, it will also require real improvements in the quantity and diversity of domestic gas supply; and measures to reduce the level and impact of market power wielded by a small number of integrated generator-retailers in the NEM;
- In the short- to medium-term at least, thermal generation will be required to deliver firmed electricity at an internationally competitive price for industry. Recent and current experiences in the contract market are showing that non-thermal options for firm contracts (batteries, hydro, pumped hydro) are not yet cost competitive at scale. Policy makers should therefore ensure there are viable future business models for thermal generation under the new policy settings;
- Even with the Guarantee, electricity prices may not fall to the level needed for electricity dependent industry to be internationally competitive, and further policy action may be required to ensure reliable electricity is available at an internationally competitive price today and a transition to future competitive supply sources is effectively managed.

The Council acknowledges that these points have either already been noted by the designers of the Guarantee, and/or are outside of the scope of issues that the Guarantee is

designed to address. Nevertheless, they remain critical issues for the immediate future of energy policy in Australia and should remain prominent in all discussions of energy policy.

Overall View

Overall, the aluminium industry is supportive of the latest steps in the design of the Guarantee, within the confines of the timelines and the high-level design. We support the continued acknowledgement of “the importance of preserving the international competitiveness of Australian businesses carrying out emissions-intensive activities” and the reiterated intention to exempt emissions-intensive trade-exposed (EITE) activities from the emissions requirement of the Guarantee. Some specific issues related to this exemption are noted later in this submission.

The Council also agrees with the technology-neutral approach of the Guarantee. The three components of the energy trilemma – cost, reliability and reduced emissions – remain the appropriate prism to view potential policies.

We wish to acknowledge the concerted effort from officials (from the Department and the Energy Security Board (ESB)) to consult extensively in the short period available for the development of the Guarantee. However, we think it should be noted that the time allocated to the development of this significant policy – and the fact that it is done in isolation of other potential changes, such as ‘day ahead markets’ – creates a high likelihood of unintended consequences and costs in electricity markets. We strongly recommend that, there be a willingness to clarify the policy intent of the design and then adjust the detail of the design to deliver the policy intent as soon as shortcomings become apparent. The necessary policy certainty to underpin investment is (as noted below) in providing certainty over the emissions intensity target over an extended period on an agreed basis at COAG, rather than in every detail of the Guarantee design remaining unchanged over time.

Our responses to the specific questions and issues raised in the Consultation Paper are set out below:

The Government’s proposed approach to setting the initial electricity emissions targets under the Guarantee.

The Council observes that it is reasonable to initially set the electricity emissions target as a proportion of the overall national reduction effort required. While the electricity sector may offer some initial low cost abatement opportunities, it is less clear that this will remain the case along the committed emissions trajectory under the Paris Agreement. In particular, as levels of intermittent renewables increase, there will be a step change in effective abatement cost as matching dispatchable generation will also need to be implemented to maintain grid reliability. Suggestions that the electricity sector's 'fair share' of emissions reduction is greater than a proportion of the national target rely on assumptions about future technology costs and changes applied to modelling of both

electricity markets and abatement costs. Modelling in both of these areas has been found wanting in recent policy history.

If there are to be sector-specific emissions abatement policies – which appears to be the policy approach of both major parties in Australia – then mechanisms should be available (linking, offsets, reviews) to ensure that the incentives for, and costs of, abatement are relatively aligned between sectors over time.

The Government's proposed approach to amending targets and setting future targets under the Guarantee.

The Council concurs with the Government, and many other stakeholders, that developing a stable policy that can underpin investment in electricity generation is a critical objective of the Guarantee.

It is therefore reasonable to “set the annual electricity emissions targets for the first ten years of the Guarantee in Commonwealth legislation. The targets would be extended by 2025 for the period 2031 to 2035 and every five years thereafter”.

Whether the proposed approach to streamline the RET and Guarantee exemption applications minimises any regulatory burden for EITE entities.

The Council agrees that the proposed approach to streamline the RET and Guarantee exemption initially minimises the regulatory burden. We further encourage the Government to bring the RET and Guarantee compliance years into alignment to fully streamline the process.

We also note that it will be necessary to adjust the exemption given under the RET to account for it being at a different measurement point. Further the design will need to recognise that there is no concept of self-generation being effectively exempt under the Emissions Requirement of the Guarantee so that in some cases the exemption will need to be adjusted for this. In practice this will also mean the electricity use method will need to be applied differently for each of the RET and the Guarantee and that the drafting of any legislation to give effect to this will need to acknowledge that while it will be one application and one assurance process, there will effectively need to be two quite separate treatments of the electricity use method as it will apply under each scheme.

Operation of the EITE Exemption

While input has not been specifically invited on other aspects of the EITE exemption, and some elements of it lie, partly or completely, within the ESB components of the Guarantee design, the Council notes the following concerns regarding delivery of the EITE exemption on its stated objective:

- Whether an EITE customer will be able to get the full benefit of the exemption is important in giving effect to the policy intent. While it is clear that the market

customer who is the liable entity will be able to use an EITE exemption certificate to reduce their obligation, it is not clear how well the EITE customer will be able to reduce their obligation to the retailer when they hand over the exemption certificate. This is because there may well be a mismatch between the basis on which costs pass through under the arrangement with the retailer and the ability of the exemption certificate to offset those costs. In simplistic terms, interpretation of contracts may be not be clear in this case where the EITE exemption is a ‘certificate’ but the emissions requirement is not a ‘certificate scheme’. A significant portion of this clarity and interpretation will arise from exactly how this is drafted in legislation and regulations. Accordingly we strongly encourage this issue to be actively considered by the Commonwealth and the ESB and for there to be detailed engagement with our members on the ways that this is best addressed in drafting.

- There are a range of ways that we think the cost of the emissions requirement could be lowered to the benefit of all consumers which will be covered in our submission to the ESB. Some of these approaches would allow a significant simplification of the treatment of EITE exemption including removing the need to apply scaling factors.
- To the extent that policy design retains scaling factors to manage EITE exemption and the exemption for the first 50,000 MWh of retailer load we have some concerns. In particular we are concerned that the scaling factor applied after the EITE load has been deducted from the retailers non-EITE load may be interpreted as the EITE exemption not providing a full exemption from the emissions requirement. We believe this is specifically not the Commonwealth or the ESB’s intention. This can be addressed with the order in which the calculation for exemption is done so that rather than deducting the EITE load before scaling, the full retailers load is scaled and the EITE exemption is scaled and then deducted. While the calculation delivers the same result, the interpretation of what is covered by the EITE exemption is potentially different.

We would welcome the opportunity to discuss these issues above in more detail with the Department and the ESB.

Whether market customers should be able to use offsets to reduce part of their emissions under the Guarantee.

The ability to use at least some level of offsets (domestic and international) to meet the emissions requirement under the Guarantee will serve a number of useful purposes. It is likely to provide some level of price/cost safety valve if the cost of abatement within the electricity sector rises too high. It may also slightly mitigate the potential for dominant players in the electricity generation and retail sectors to have undue influence on the cost of abatement passed through to electricity customers. Finally, as noted above, the use of offsets is one mechanism to maintain parity in emissions reduction costs between sectors in the economy.

The proposed approach to using offsets to be used for compliance under the Guarantee.

The Council has no specific comment on the proposed approach to using offsets.

I am happy to provide further information on any of the issues raised in this letter. The Council looks forward to engaging more through further development of the National Energy Guarantee.

Yours sincerely



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