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NATIONAL ENERGY GUARANTEE - DRAFT DETAILED DESIGN CONSULTATION PAPER

Thank you for the opportunity to provide a submission on the consultation paper: *National Energy Guarantee - Draft Detailed Design Consultation Paper*. 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:

- Historically Australia has attracted and maintained investment in many industries – including alumina refining and aluminium smelting - due to internationally competitive costs of energy (itself due to an endowment of energy resources). Australia no longer has internationally competitive energy costs and this has halted investment in those industries and is imperilling the viability of existing assets.
- Australia's world class conventional and renewable resources should be the basis for internationally competitive energy pricing for Australian industry.
- The ultimate test of Australia's energy policy will be whether Australia can return to internationally competitive energy costs – particularly for electricity.
- 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 have any chance 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. In our submission to the Commonwealth we supported 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 Energy Security Board (ESB) and the Department) 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 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.

In our response to the recent consultation paper on Commonwealth Design Elements we noted the following points:

- Support for the proposed structure and timing of setting electricity emissions targets under the Guarantee;

- Support for the appropriate use of offsets as a flexibility tool, and to mitigate potential negative impacts;
- Support for the proposed approach to streamline the RET and Guarantee exemption applications to minimise regulatory burden for EITE entities; and
- Specific comments on the operation of the EITE exemption which are also included here as they are relevant to this submission.

Our responses to some specific issues raised by the Consultation Paper are set out below:

Emissions reduction requirement

- We recommend that the Guarantee should not impose an administrative (or other) requirement on generators “to allocate all generation and associated emissions by the reporting and compliance date” as this may undermine the business model of dispatchable (thermal) generation and that generation is needed to undertake any transition effectively. We propose that there be the flexibility for some generation to be allocated to a residual pool.
- In order to minimise scheme costs and the potential for unintended consequences, the ESB should consider structuring the emissions reduction requirement in a comparable way to the reliability component – that is, the full mechanics of the required audit, reporting and contracting should only be triggered if the forecasts suggest that the emissions targets may not be met. There is a real prospect that the architecture of the Guarantee will ensure that the NEM evolves in a way that will meet both the emissions and reliability objectives and it is not necessary to trigger the full reporting and contracting requirements and associated costs.

Operation of the EITE Exemption

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 ESB and the Commonwealth and for there to be detailed engagement with our members on the ways that this is best addressed in drafting.

- To the extent that policy design retains scaling factors to manage the EITE exemption and the exemption for the first 50,000 MWh of retailer loader 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 ESB's or the Commonwealth'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.

Liabe party for the reliability requirement

- We recommend that retailers should be the liable entities for the reliability requirement for all customers with whom they have a retail contract during the relevant period. A retailer's commercial imperative to hedge a retail contract goes hand in hand with the obligation to ensure that those hedges secure reliability. Having entered into a retail contract, a retailer should be expected to take reasonable steps to ensure that the customer receives a reliable supply of electricity at the agreed price, which will be defined by the reliability requirement. This will avoid a circumstance where customers with retail contracts are confronted with having to pay their retailer additional charges to transfer a liability to meet the reliability requirement once that requirement has been triggered, or where customers are offered retail contracts that do not include transfer of the liability and they have no commercially sensible options to offset their liability elsewhere.
- We also recommend that customers should have the option to "opt in" and take on the liability to meet the reliability requirement. This would enable customers to manage the liability themselves where they believe they are able to do so more economically than through a retailer.

Grandfathering pre-existing contracts

- The Council supports the grandfathering of pre-existing large customer contracts without firmness testing, to preserve the original intent of contracts that, in the case of the aluminium sector, are core to business. To be effective, the grandfathering provisions will need to ensure that the large customers are effectively exempt from any fees or charges associated with the reliability requirement for the volume and term of those agreements.

Market Liquidity Obligation

- The Council supports the concept of a Market Liquidity Obligation (MLO) on those large market participants that trade in the electricity market on the grounds that it would improve market transparency and should improve market liquidity, and those parties have the necessary capabilities to meet the MLO.
- The Council is of the view that the MLO should not extend to other parties, in particular large customers that also manage generation capacity for the primary purpose of supplying their own load.

Equal market access for all customers and retailers

- The Council recommends that the Guarantee framework should ensure that all customers should have equal market access to qualifying contracts that satisfy the compliance obligations. In particular, the Council is concerned about the proposal to allow retailers alone to adjust their positions after the qualifying contract compliance date.
- In general, contracts entered into further in advance of the dispatch date are likely to be more expensive than those entered into nearer that time, as generators gain greater confidence about their availability closer to dispatch time and are more willing to offer increased volumes of contracts. Allowing retailers to contract later than large customers would give those retailers and their customers an advantage over large customers, which the Council considers is against the principles of a fair market.

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

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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