Investor Group on Climate Change

# Investor Group On Climate Change (IGCC)

Submission to:

# NATIONAL ENERGY GUARANTEE

# DRAFT DETAILED DESIGN

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## EXECUTIVE SUMMARY

The Investor Group on Climate Change (IGCC) supports robust, investment-grade policies to reduce emissions. Investors are looking for policy which delivers clear and transparent market signals which support investment confidence and improved risk management, and which brings private sector investment to market.

The IGCC has identified six core criteria the National Energy Guarantee to be a successful policy mechanism to drive new investment in low emissions energy technologies, while being credible in the context of a global economy under transition. Any effective policy must deliver a signal for new investment in accordance with international commitments under the Paris Agreement. These core criteria are:

1. The National Energy Guarantee has to deliver genuine investment certainty: this can only be delivered by genuinely reconciling climate and energy policy, delivering outcomes consistent with the goals of the Paris Agreement.

2. Design considerations for the National Energy Guarantee must be in the context of a comprehensive suite of current and proposed energy and climate policies.

3. The National Energy Guarantee must avoid excessive complexity, administrative and regulatory burdens which increase cost for business and households. It must avoid further over-investment in gold-plating and inefficient expenses.

4. The National Energy Guarantee has to deliver an efficient market, promoting an open, transparent and competitive electricity market solution.

5. The National Energy Guarantee has to support environmental ambition with credible environmental outcomes and allow for a scalable emissions reduction trajectory in line with the Paris Agreement.

6. Build it to last: The National Energy Guarantee design has to deliver a policy framework which is flexible and responsive to rapidly changing market and technological conditions over time, without further regulatory or political interventions.

IGCC welcomes the opportunity to provide feedback to the Department of the Environment and Energy. We would be happy to facilitate further engagement with the institutional investor community to discuss the design of the National Energy Guarantee and issues set out in this submission.

## Introduction and overview

IGCC represents over 70 Australian and New Zealand institutional investors with more than $2 trillion of funds under management, along with members of the investment community focused on the impacts of climate and energy issues.

IGCC members are invested across the Australian economy and are part owners of most of Australia's large companies. As managers of retirement savings and pooled investments we are concerned with the evident and increasing impacts of climate change on the global and Australian economies and the flow through impacts for investment returns.

Australia's response to climate change needs be inclusive of considerations for the economic and investment implications of the global response to climate change. This includes the setting out a practical pathway for ensuring Australia's economic competitiveness in a carbon constrained global operating environment over the longer term.

The National Energy Guarantee provides an opportunity to establish a workable policy mechanism to drive down emissions within the electricity sector while scaling up investment in crucial new generation capacity needed to maintain system reliability and put downward pressure on electricity prices.

There is a need for a meaningful and robust alignment of Australia's climate and energy policy. As a mechanism, the National Energy Guarantee has the potential to deliver this certainty. However, there are a few outstanding design considerations that should be addressed to ensure it provides a credible market signal for investors.

### Investors are calling for action

Investors are already taking action on climate change. A global, low carbon, transition is underway. Investors are leading the way through significant investments in low carbon technologies, climate resilient infrastructure and supporting the transition away from fossil fuels.

More needs to be done by Governments to accelerate the low carbon transition and build investor momentum and confidence. By putting in place credible policy, governments can unlock the significant amounts of capital required to drive this transition.

In June 2018, a total of 319 investors, responsible for more than USD $28 trillion in assets joined as signatories to the 2018 Global Investor Statement Governments on Climate Change ahead of the meeting of G7 heads of state.[1]

Through the statement, investors called on Governments to deliver on the three core principles:

1. Achieve the Paris Agreement's Goals;
2. Accelerate private sector investment into the low carbon transition; and
3. Commit to improve climate-related financial reporting.

Central to these principles was an acknowledgement by investors that we must proactively transition away from fossil fuels. Through the statement, investors called for a phase out of fossil fuel subsidies, as well as a phase out of thermal coal power by set deadlines.

Additionally, investors have collectively called on governments to address the "ambition gap". Implementation of the current emissions reduction commitments made by Governments is insufficient for meeting the Paris Agreement goal of limiting global warming to well below 2 degrees above pre-industrial levels.

Investors are seeking the introduction of credible policies to build momentum and maintain investor confidence, and to set emissions reduction targets that reflect an appropriate level of ambition to support work towards decarbonisation of the economy.

## Emissions Reduction Targets

To ensure the National Energy Guarantee can serve as an effective and genuine mechanism to promote efficient investment in the National Electricity Market, the level of ambition reflected by the greenhouse emissions reduction task assigned to it must be addressed.

Commitment to the Paris Agreement requires the introduction of policy measures and emissions reduction targets that are consistent with achieving the agreement's goals. Investors are looking to governments, as signatories to the agreement, to set long-term targets that are consistent with limiting global warming to well below 2 degrees.

This includes commitment to long-term emissions reduction targets, consistent with achieving net zero emissions by the second half of this century. Governments must commit to ambitious interim targets, to establish a trajectory towards meeting these long-term targets.

[1] The Investor Agenda, *2018 Global Investor Statement to Governments on Climate Change,* 4 June 2018 - https://theinvestoragenda.org/wp-content/uploads/2018/06/GISGCC-FINAL-for-G7-with-signatories_-update-4-June.pdf

In July 2015, the Climate Change Authority (CCA) delivered the *Final Report on Australia's Future Emissions Reduction Targets*. In this report, the CCA recommended that an emissions reduction target within a range of 45 to 65 per cent below 2005 levels by 2030. This target was seen as Australia's fair share of international efforts towards the Paris Agreement's goals.

With the Australian Government's commitment to reducing emissions by 26 per cent below 2005 levels by 2030, there remains a significant degree of uncertainty around how and when the gap to establishing a target consistent with the Paris Agreement will be bridged.

### Review process for targets

The Commonwealth must commit to reviewing Australia's greenhouse gas reduction target and establishing a new Nationally Determined Contribution that represents a level of ambition consistent with the Paris Agreement goals, and in line with independent, expert, advice.

An effective policy to drive new investment in energy infrastructure as part of a wider transition to a low carbon economy must be responsive to market dynamics, the emergence of new innovations and evolving consumer needs. This requires an emissions reduction objective that is dynamic and adjustable, rather than one that is rigid.

The proposal to lock-in an initial emissions trajectory for a 10-year period in legislation will act as a source of investor uncertainty. Under the National Energy Guarantee, a process for reviewing and setting ambitious emissions reduction targets, in-line with the process for updating National Determined Contributions under the Paris Agreement, must be established.

Experience has shown that energy markets, and the management of associated greenhouse gas emissions, can evolve rapidly and benefit from built in review processes that allow design parameters such as targets to be adjusted without needing further legislative amendment. Prior experiences of the Commonwealth Renewable Energy Target, State-based energy efficiency schemes and international efforts to limit emissions can be rapidly influenced by technological innovations and macro-economic factors.

To build confidence in the long-term ability of the National Energy Guarantee to deliver a strong investment signal, a mechanism for regular review and setting of national emissions reduction targets should be incorporated into the National Energy Guarantee.

Such a review mechanism will provide certainty to investors that a credible and meaningful investment signal for investment in reliable, low emissions, sources of electricity generation can be established under the National Energy Guarantee and maintained for the long-term.

### Target for the Electricity Sector

Compounding the issue of emissions reduction ambition is the allocation of a proportional emissions reduction target for the electricity sector. This raises the question of how the remainder of the abatement task will be allocated to the other sectors of the economy.

Again, this is a significant source of uncertainty for investors and raises questions around how the emissions reduction burden will be carried by the remaining sectors of the Australian economy.

Ultimately, this will put greater cost pressures on the agriculture, transport, manufacturing and resources sectors, which are all experiencing increases in annual emissions, to meet even the current 26% economy wide emissions reduction target.

The Safeguard Mechanism will at best limit growth in emissions, and its current design will not drive the emissions reductions needed to meet even the existing emissions reduction targets. Significant uncertainty remains over how the remainder of the emissions abatement task will be achieved.

The electricity sector is the largest single source of greenhouse gas emissions within Australia. As a sector that is undergoing significant transformation with the emergence of cost-competitive and low emissions sources of energy, the electricity sector can and should be tasked with undertaking deeper emissions reductions.

### Additionality of voluntary schemes

Businesses and consumers have already proactively sought to reduce their emissions footprint on a voluntary basis, above and beyond the targets set by Governments. The integrity of these additional, voluntary, actions must be protected under any national emissions reduction policy.

Examples of voluntary schemes include the GreenPower scheme for purchasing additional electricity from renewable energy sources, and the off-setting of emissions under the National Carbon Offset Standard.

A coherent mechanism for accounting for voluntary action must be established under the National Energy Guarantee.

The operation of this mechanism should facilitate the additionality of State and Territory schemes, allowing for investment and emissions reductions incentivised by those schemes to be counted as additional to those driven by the National Energy Guarantee.

Consumers within these jurisdictions are providing the means for these additional actions. The additionality of these schemes is essential to avoid other jurisdictions from effectively free-riding on contributions to achieving national emissions reduction targets and undermining the objectives and outcomes of the schemes set by State and Territory Governments.

The additionality of State schemes, and the voluntary actions of consumers, may provide some means of bridging the gap between current Commonwealth Government emissions reduction commitments and those required to meet the goals of the Paris Agreement.

## Emissions Intensive Trade Exposed Industries (EITE)

IGCC does not believe that the proposed interaction between the National Energy Guarantee, emissions intensive trade exposed industries and the National Electricity Market necessitates special exemptions for EITEs from liabilities.

Under current rules, approximately one-fifth of Australia's electricity demand is covered by EITE exemptions under the Renewable Energy Target. Under the RET, and as proposed under the National Energy Guarantee, the cost of liabilities for these EITE exemptions are borne by the remaining electricity consumers.

The case for extending EITE exemptions under the National Energy Guarantee has not been made clear, and IGCC believes that it will add to the administrative complexity and costs associated with the operation of the scheme as a whole. Carve-outs for EITEs under the National Energy Guarantee will result in inefficiencies, and an obfuscation of the investment signal it seeks to provide.

In recognition of the threats posed by climate change, many large manufacturers have reduced their exposure to future costs on carbon emissions, by working to lower their emissions footprint and diversifying their sources of energy. Those who will be most impacted by the EITE exemptions are vulnerable electricity consumers and the case for shifting a cost-burden onto them needs to be made.

However, if exceptions for EITEs are to be provided under the National Energy Guarantee, IGCC agrees that there is a clear argument that they should mirror those of the Renewable Energy Target as closely as possible. This would take advantage of the reduce regulatory complexity that would come with streamlining EITE exemptions between the two schemes.

## External Offsets

IGCC in principle supports the inclusion of offsets as a means of providing compliance flexibility for liable entities under an emissions reduction policy. However, the use of offsets under the National Energy Guarantee must not detract from investment in meaningful emissions reductions in the electricity sector.

At least initially, the inclusion of offsets under the emissions guarantee should focus on suitable domestically generated offsets, such as the Australian Carbon Credit Units (ACCUs) issued under the Emissions Reduction Mechanism.

This will both ensure the quality of these offsets remains high, while providing the potential for an additional market for such offsets that can extend beyond the direct procurement of offsets as currently occurs under the Emissions Reduction Mechanism.

IGCC agrees that measures to avoid effective double counting of emissions reductions attributed to the production of ACCUs should be implemented to maintain the integrity of these offsets and that of the National Energy Guarantee.

To ensure retailers are incentivised to seek out cost-effective actions within the National Electricity Market to reduce the emissions, the use of offsets should also be capped to a certain portion of a retailer's emissions liability, while providing a means of compliance flexibility.

By placing a cap on the level of offsets that may be used under the National Energy Guarantee, the signal for further investment for new sources of low emissions generation capacity will be preserved, while effectively providing additional liquidity in the market for emissions allocations.

As there is no detail nor established mechanism to facilitate the introduction of international units into the National Energy Guarantee, it is not possible to accurately gauge what impact they may have on local abatement activities. There is insufficient information available to allow IGCC to support international offsets at this time.

## Conclusions and Recommendations

Australia needs an effective and credible energy and climate policy to unlock investment in new generation and address high energy prices for business and households. The National Energy Guarantee has to credibly address environmental ambition in order to strengthen system wide reliability considerations.

In reviewing the draft detailed design consultation paper issued by the Department of the Environment and Energy, IGCC has sought to provide constructive feedback on the questions published for further consultation.

The National Energy Guarantee provides an opportunity to establish a workable policy mechanism to drive down emissions within the electricity sector while scaling up investment in crucial new generation capacity needed to maintain system reliability and put downward pressure on electricity prices.

The National Energy Guarantee provides a policy framework that can provide the long-term policy certainty that the National Energy Market has desperately lacked for more than a decade.

However, IGCC remains concerned that the proposed National Energy Guarantee does not yet adequately address a number of core criteria investors consider to be crucial to delivering investment certainty and unlocking much needed capital to build the low carbon energy generation system of the future.

To build confidence in the long-term ability of the National Energy Guarantee to deliver a strong investment signal, a mechanism for regular review and setting of national emissions reduction targets, with an aim to ramping up ambition, should be incorporated into the National Energy Guarantee.

With international commitment to the Paris Agreement, investors are now looking to Governments to put in place policies and targets that are consistent with the aims of the Paris Agreement. Until such time as sufficiently ambitious emissions reduction targets are put in place, investors will still face an environment of uncertainty.

IGCC would be happy to facilitate further discussion with investors on the design of the National Energy Guarantee, and related policies, as part of this review.

We look forward to continuing to constructively engage in further discussions with the Department, the Energy Security Board and with the members of the COAG Energy Council on these matters as consultation on the design of the mechanism progresses.