Investor Group on Climate Change

INVESTOR GROUP ON CLIMATE CHANGE

Submission to:

ENERGY SECURITY BOARD

NATIONAL ENERGY GUARANTEE

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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 better risk management over time and which bring private sector investment to market.

The IGCC have identified six core criteria for a successful policy mechanism to drive new investment in low emissions energy technologies and while being credible in the context of a global economy under transition in accordance with international commitments under the Paris Agreement. These core criteria are:

1. The NEG has to deliver genuine investment certainty: this can only be delivered by genuinely reconciling climate and energy policy.

2. Design considerations for the NEG have to reference the whole suite of current and proposed energy and climate policies.

3. No gold-plating or undue expense: The NEG must avoid excessive complexity, administrative and regulatory burdens which increase cost.

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

5. The NEG has to support environmental ambition with credible environmental outcomes and a scalable emissions reduction trajectory in line with the Paris Agreement.

6. Build it to last: The NEG design has to deliver a policy framework which can flex and respond to rapidly changing market and technological conditions over time, without ongoing major regulatory or political interventions.

IGCC welcomes the opportunity to provide feedback to the Energy Security Board. 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

The Investor Group on Climate Change (IGCC) represents over 65 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 need for investment certainty

As long-term investors, institutional investors are acutely aware of their fiduciary duties and obligations under the regulatory framework for institutional investors in Australia. In recent years, it has become increasingly clear that this obligation extends to the oversight and management of environmental, social and governance factors influencing financial performance, including climate change.

Building on over a decade of examining the alignment of financial and environmental risks, in June 2017, the Memorandum of Opinion "Superannuation Fund Trustee Duties and Climate Change Risk" was published, authored by Noel Hutley QC and James Mack[1]. This looked explicitly at the provisions of the Superannuation Industry Supervision Act 1993 (SIS Act) relating to fiduciary duties and climate change.

The SIS Act requires that a Trustee Director must act in the best interests of "beneficiaries" and must exercise due care, skill and diligence in relation to all matters affecting a registrable superannuation entity.

The Opinion found that "Climate change risks can and should be considered by trustee directors to the extent that those risks may intersect with the financial interests of a beneficiary of a superannuation fund." It also found that in relation to Prudential Standard SPS 530 Investment

[1] Noel Hutley and James Mack (commissioned by Market Forces), 'Superannuation Fund Trustee Duties and Climate Change Risk' (Memorandum of Opinion, Environmental Justice Australia, 2017) 5 [10].

Governance 2013 (SPS 530), "the financial effect of climate change risk factors may need to be identified, so too the sources of return with which such factors are associated"[2].

Comments by Geoff Summerhayes, Executive Board Member of the Australian Prudential Regulation Authority (APRA) in February 2017 and again in November 2017, clearly articulated that regulators see climate change risk as “distinctly financial in nature” with “many of these risks foreseeable, material and actionable now".[3,4]

APRA has strongly signalled that they expect investors to engage in sophisticated analysis and to be in a position to articulate how climate risk might impact business operations and strategies for managing material impacts.

With a heightened awareness of the need to be actively identifying and managing climate change risk factors in investment decision making – the impact of climate policy in investment decisions has become more pronounced and is driving changed investment behaviour.

Investors will not allocate capital to assets where they do not feel they can accurately price the carbon risk associated with the investment. we have seen the consequences of policy inaction or uncertainty, with the recent high wholesale electricity prices, supply disruption and disorderly withdraw of generation from the network.

Lack of regulatory certainty around energy and climate policy has been a key driver in the investment strike Australia has seen in the energy sector in recent years, as investors adopt a ‘wait and see’ approach to the reconciliation of energy and climate policy and politics.

As such, investment certainty in Australia for the energy sector comes in two parts – the first will come from the establishment of a durable policy mechanism able to withstand changes in government.

The second aspect of investment certainty comes from the credibility of the emissions reductions delivered and the ability of the policy mechanism to close the gap between Australia’s current trajectory and the goals of the Paris Commitment. This includes both our current emission reductions targets and the ability to scale up to meet emission reductions required to hold global

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[2] Hutley and Mack, [11].

[3] Geoff Summerhayes, 'Australia's new horizon: Climate change challenges and prudential risk' (Speech, 17 February 2017, Insurance Council of Australia Annual Forum, Sydney) <http://www.apra.gov.au/Speeches/Pages/Australias-new-horizon.aspx>

[4] Geoff Summerhayes, ‘The weight of money: A business case for climate risk resilience ‘, (speech 29 November 2017, Centre for Policy Development, Sydney) < http://www.apra.gov.au/Speeches/Pages/The-weight-of-money.aspx>

warming to less than 2°C and move to a net zero emissions economy by the second half of the century. Any transition to a low carbon energy system must also support the provisions under the Paris Agreement for a 'Just Transition'.

Without addressing these two key questions of political durability and climate credibility, the National Energy Guarantee will not deliver investment certainty in the eyes of investors deploying capital into the sector.

Core criteria for investors

In assessing whether or not the proposed design for the National Energy Guarantee is able to deliver the policy certainty necessary to unlock investment in the energy sector, IGCC has identified six core criteria that the NEG will need to address. These are consistent with the policy position IGCC has held for over a decade.

CRITERIA 1:

> *The NEG has to deliver genuine investment certainty: this can only be delivered by genuinely reconciling climate and energy policy.*

Policy related risk has been the biggest barrier to new investment in electricity generation infrastructure in Australia over the last decade, significantly contributing to the challenges that the National Energy Guarantee seeks to address.

The design and operation of the mechanism will be critical to the restoration of investor confidence in energy investment. The ability of the mechanism to deliver a durable and credible market signal consistent with international climate commitments is key to building that confidence.

A credible and ambitious emissions reduction target, paired with an efficient, market-driven policy mechanism for reshaping the energy market, is crucial to provide investor certainty and to effectively drive the transition towards a decarbonised economy over the longer term.

CRITERIA 2:

> *Design considerations for the NEG have to reference the whole suite of current and proposed energy and climate policies*

The NEG will not operate in isolation. The policy mechanism must be developed with full consideration to a wider suite of energy and climate policies, including the Finkel recommendations on energy reliability and security, and whole of economy climate change policy implications. It is not possible for investors to accurately assess the effectiveness of the NEG without considering the full effect of energy and climate policy.

IGCC acknowledges that the Energy Security Board and the COAG Energy Council have been deeply engaged with reforms to the National Electricity Market following the Finkel Review. The

Finkel Review outlined a considerable number of detailed recommendations as part of a proposed plan for reforms to the National Electricity Market.

Many of the Finkel recommendations directly address the need for improved reliability in the National Electricity Market. These include:

- Ensuring major generators provide a three-year notice of their intention to close
- Improved extreme weather and demand forecasting
- Strengthened arrangements under the Reliability and Emergency Reserve Trader regime, including the option of establishing an additional out of market strategic reserve mechanism.

IGCC welcomed many of the recommendations adopted from the Finkel Review and the work being undertaken by COAG members to strengthen the operation of the electricity market. The efficacy of the NEG must also be assessed in the context of other measures, or lack thereof, being undertaken to reduce emissions across the rest of the economy.

The Government has indicated that it will pursue an emissions reduction target of 26% below 2005 levels by 2030 nationally. The electricity sector accounts for 35% of Australia's total emissions and is considered to be the most cost-effective source of significant abatement across the economy. However, if an emissions reduction target of 26% is applied to the electricity sector, then a significant abatement task will remain outstanding for the rest of the economy.

If the abatement task for reaching Australia's emissions target will be applied on a pro-rata basis across all sectors of the economy, the question of how emissions reductions will be achieved beyond the electricity sector remains, and implications for the cost of abatement burden now required for other industry sectors must be addressed.

It is also noted that this target itself is still considered inconsistent with the international commitments made under the Paris Agreement on Climate Change to limit global warming to no more than 2 degrees above pre-industrial levels, which according the Climate Change Authority imply an emissions reduction target between 45% to 65% below 2005 levels by 2030.[5]

CRITERIA 3:

> *No gold-plating or undue expense: The NEG must avoid excessive complexity, administrative and regulatory burdens which increase cost*

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[5] Climate Change Authority, Final Report on Australia's Future Emissions Reduction Targets, 2 July 2015 <http://www.climatechangeauthority.gov.au/sites/prod.climatechangeauthority.gov.au/files/files/CFI/Final-report-Australia-future-emissions-reduction-targets.pdf>

Much has been said of the trilemma facing the Australian energy system, with a need to ensure stability and reliability of supply while maintaining cost effectiveness for consumers and reducing emissions. It is therefore critical that any policy introduced to shape the future energy system does so in a way that does not inadvertently increase the regulatory burden, and as a result, increase the flow through costs for consumers and end users.

The most efficient mechanism for reducing emissions in our energy system is to establish a mechanism that attaches an economy-wide price on greenhouse gas emissions. In the absence of a carbon price, reducing the level of emissions through regulation of the National Electricity Market must be done in an equally efficient manner.

It is vital that the proposed mechanism does not inadvertently repeat the mistakes of the past, where reliability is effectively 'gold plated' through regulatory interventions which distort market and investment behaviour driving up administrative complexity resulting in increased costs for end users.

The resulting market signal must ensure investment in new generation capacity and supply firming infrastructure is commissioned at an efficient price and by a time when it is required.

If new regulatory arrangements are imposed on the energy market, then they must only be introduced where they provide an overall benefit to the system. The introduction of a regulatory regime that simply duplicates current practice or yields little measurable benefits for system operation and the quality of supply for consumers is simply inefficient and is likely to be to the detriment of all market participants.

CRITERIA 4:

> *The NEG has to deliver an efficient market, promoting an open, transparent and competitive electricity market solution.*

Any mechanism introduced to drive reductions in emissions in the electricity sector, and across the wider economy, must deliver an efficient and transparent mechanism for price discovery. Liquid and transparent markets provide greater certainty for market participants and work towards achieving efficient market outcomes that drive down emissions.

Currently the NEG does not support a wholly transparent price on emissions, but rather internalises or embeds emissions pricing implications into other forms of contract exchange.

Transparency in markets must ensure that all active participants in the market are able to work on a level playing field. Current market structures within the National Electricity Market have the potential to favour participants who hold a significant share of both the customer and generation base, and any policy mechanism that works to shape the future energy system must avoid measures which benefit incumbents to the detriment of smaller or new players.

The NEG must be designed to allow new participants to enter the market and be sufficiently flexible to allow emerging technologies to contribute to the modernisation and decarbonisation of the energy sector.

CRITERIA 5:

> *The NEG has to support environmental ambition with credible environmental outcomes and a scalable emissions reduction trajectory in line with the Paris Agreement.*

Action on climate change will require a shift away from emissions intensive sources of energy, and a forward-looking plan to manage this transition is essential to minimise the financial risk from stranded assets and unlock investment in alternative low emissions energy technologies.

The very challenges that the National Energy Guarantee is looking to address in the energy sector have been largely caused because investors have been unwilling to invest in the energy sector without a credible climate change policy in place. If the targets embedded within the proposed NEG are considered weak, ineffective or misaligned to Australia's obligations under the Paris Agreement, then those risks will remain, and investment uncertainty will not be substantively addressed.

To be credible, an emissions reduction target must be consistent with the Paris Agreement to limit global warming to less than 2 degrees above pre-industrial levels and move to a net zero emissions economy by the second half of the century.

CRITERIA 6:

> *Build it to last: The design has to deliver a policy framework which can flex and respond to rapidly changing market and technological conditions over time, without ongoing major regulatory or political interventions.*

Technological progress in the energy sector has consistently out-performed market forecasts, with the cost of renewable energy technologies falling faster than historical predictions, leading to levels of uptake exceeding expectations.

In addition, the emergence of new energy technologies that allow for greater control of when and how energy is used has reshaped what a future energy system will look like. The increasing cost effectiveness of renewable energy technologies represents a challenge for incumbent coal and gas generation as is the emergence of distributed energy technologies. These technologies can provide greater flexibility in how energy is delivered to consumers without the need for significant investments in the infrastructure required to connect consumers with decentralised generation capacity.

It is therefore imperative that predictable and stable policy design, that facilitates rather than interferes with the market, is put in place. Without such support, there is a high likelihood that the rapid and rough transition currently underway in the energy sector will continue without any high-level direction, leading to higher prices and poorer outcomes for both end users and the environment.

Responses to Chapter 3 - Energy Security Board Consultation

The Investor Group on Climate Change has long advocated for a market-based carbon pricing mechanism. This remains our position.

In line with the six core criteria outlined in this submission for assessing the potential effectiveness of a policy mechanism, the IGCC encourages the Energy Security Board to consider the need for open, transparent and competitive electricity markets to stimulate investment in low emissions energy technologies.

The IGCC has provided the following feedback on certain aspects of the Energy Security Board's draft design consultation paper in relation to the Emissions Guarantee. IGCC has not sought to provide feedback on every question put forward in the consultation paper, but rather to provide input on key questions for consideration.

Offsets

IGCC is supportive of the inclusion of high-quality offsets as a means of providing flexibility for electricity retailers in meeting their obligations under the emissions guarantee. Offsets can provide a useful source of market liquidity with regards to emissions reductions and can stimulate investment in emissions reductions across a diverse cross-section of the Australian economy.

However, appropriate limits should be placed around the type and use of offsets under the scheme, so that their inclusion does not undermine the environmental effectiveness of the scheme as a whole.

Such limits should relate to the proportion of a retailer's liability that may be met through the use of offsets, and where and how those offsets may be sourced. As a credible international mechanism for the generation and transfer of offsets into the Australian market does not yet exist, international offsets should not be included until the mechanism has been established. These can be introduced at a future date, potentially alongside increases in the targets associated with emission reductions. Inclusion of international units should be flagged well in advance to inform the market.

Further feedback on the inclusion of offsets have been in a later part of this submission, in response to consultation questions posed by the Commonwealth Government.

Voluntary programs and additionality

At their core, the value generated by voluntary nature of schemes such as the GreenPower program comes from the additionality that they provide above and beyond those mandated by State and Commonwealth policy. If the additionality of the GreenPower program was to be undermined, then there would be no rationale for consumers to opt-in to participate in the scheme, particularly as the cost of compliance for the relevant Commonwealth policy, in the case of GreenPower being the Renewable Energy Target, is already factored into the cost of electricity paid by consumers.

The National Energy Guarantee should therefore be designed with some mechanism that facilitates the explicit additionality of voluntary actions undertaken by consumers. This could include accounting for any offsets allowed under the National Energy Guarantee, whereby actions undertaken as part of a recognised activity to reduce emissions are recognised and factored into the calculation of emissions levels and annual targets.

The further benefit of having an additionality mechanism built into the National Energy Guarantee would be that it could be used as a means of recognising the actions undertaken as a result of policies implemented by sub-Commonwealth level jurisdictions.

Many States and Territories have implemented ambitious policies in support of action to reduce emissions and support the update of renewable energy projects. In all cases, these policies are designed to meet specified emissions reduction targets introduced in those jurisdictions. Many have also underpinned substantive investment in renewable energy projects, which are now contributing towards Australia's ability to meet emission reduction targets under the Paris Agreement.

The Commonwealth should work with State and Territory Governments to build upon their successes at driving new investment in clean energy technologies and ensure that the Commonwealth Targets and emissions reductions achieved under the National Energy Guarantee are additional to those driven by State and Territory initiatives.

Reporting and compliance

The IGCC supports the alignment of compliance periods with financial years, such that reporting data can be provided by companies can be made consistent with other forms of financial reporting wherever possible, or at least aligned with emissions and energy reporting under National Greenhouse and Energy Reporting obligations.

Compliance flexibility is an important feature of many policy mechanisms as it recognises the inherent nature of the market for energy and emissions to undergo variations from year to year. The IGCC supports the carrying forward of over or under - achievement into future years, but for a limited period of time.

The Renewable Energy Target provides a model for how under-achievement can be effectively deferred for a maximum of three-years, where liable entities can provide a payment of a short-fall charge to the Clean Energy Regulator corresponding to the level of under-achievement. Liable entities have a period of three years within which they may retroactively meet compliance with the RET by surrendering renewable energy certificates and subsequently reclaim the value of the short-fall charges previously paid.

Such a model may be applied for the eligibility mechanism, allowing for under or over achievement with the obligation to be made-good within a limited timeframe, such as 12-months.

To ensure accurate data collection and to maintain the integrity of the scheme, linkages between compliance mechanisms and existing registers must be established. In the scenario where offsets are allowed to be used to meet compliance under the emissions obligation, linkages with the Australian National Register of Emissions Units (ANREU) must be established to avoid double counting and for the appropriate treatment of offset units, such as ACCUs, within the registry.

Finally, it should be explicitly acknowledged that compliance across the scheme will be a critical input into determining Australia's ability meet emission reduction goals under the Paris Agreement. Therefore, non-compliance data of the operation of the emissions obligation of the NEG as a whole should also be linked to forecast tracking against Australia's 2030 emissions reduction goals and review and ratchet process under the Paris Agreement.

Responses to Chapter 4 – Commonwealth Government Consultation

The IGCC notes that three core areas for consultation have been posed by the Commonwealth Government as part of the process of designing and implementing the National Energy Guarantee – targets, offsets and the treatment of Emissions Intensive Trade Exposed industries (EITEs).

To successfully facilitate the transition of the National Electricity Market to a system that adopts greater use of lower emissions generation technologies while maintaining supply reliability and affordability for consumers, both the target and the means of achieving those targets carry equal importance.

The IGCC sees the level of emissions reduction ambition set to be achieved by the National Energy Guarantee as crucial to the successful operation of the scheme as a whole. Additionally, the inclusion of exemptions for Emissions Intensive Trade Exposed Industries and the allowance of offsets could have significant impacts on the efficient operation of the National Energy Guarantee.

Targets and Ambition

The investment community recognises the need for swift and ambitious action on climate change. The Paris Agreement established an international commitment for addressing climate change, including limiting global warming to less than 2°C above pre-industrial levels.

To provide confidence to investors and the wider energy market, emissions reduction ambition under any energy policy mechanism must be consistent with the international commitment made under the Paris Agreement. Therefore, the ability of the scheme to deliver increased ambition and scale up emissions reductions is a key consideration.

The Commonwealth Government's current target to reduce emissions by 26% from 2005 levels by 2030 is likely to be an insufficient national contribution to the global effort of limiting global warming to less than 2°C and moving to a net zero emissions economy by the second half of the century. IGCC supports an emission reduction target of at least -45%, as proposed by the Climate Change Authority.

As a major source of low cost emissions abatement, transposing the -26% reduction target over to the electricity sector also doesn't appear to represent a fair contribution to Australia's abatement challenge. It also risks increasing the cost of the emissions reduction challenge for other sectors of the economy, less able to achieve large scale abatement at an efficient cost. This would appear to be an economically inefficient means of achieving national emission reductions.

IGCC does subsequently not support the model proposed under the National Energy Guarantee, where this target range is then effectively locked in for ten-year period, limiting the ability of the scheme to scale up emission reduction targets.

IGCC supports an alternative model, whereby five year rolling targets are instituted. For example, the 2026 target would be set in 2021, the 2027 target set in 2021 and so forth. This should be supplemented with a longer term 2030 and 2050 decarbonisation trajectory for the electricity sector which is aligned and review in line with review and ratchet periods under the Paris Agreement and which includes the same provisions for 'no backsliding'.

IGCC believes that this approach would balance both flexibility and certainty in driving longer term investment and providing a straightforward means for ambition to be scaled-up under the scheme, while also meeting short term market requirements.

The effectiveness of the National Energy Guarantee and the level of ambition adopted by the Commonwealth Government are inherently interlinked. The success of the mechanism is deeply dependent on its ability to drive new investment in the electricity sector to support the emergence of new low emissions sources of energy and replace end of life, emissions-intensive retiring generation with low carbon alternatives.

Credible emissions reduction targets are a key requirement for investor certainty in an energy sector undergoing a transition towards decentralisation and decarbonisation.

The setting of emissions reduction targets for the electricity sector, and the translation of these targets into emissions intensity targets under the emissions guarantee must be interwoven with the Commonwealth Government's processes for making and reviewing emissions reduction pledges under the Paris Agreement.

By providing regularly updated interim targets, along with ambitious long-term targets, investors will be provided with a detailed trajectory for reducing emissions in the electricity sector that is both credible and responsive to market developments.

Emissions Intensive Trade Exposed Industries

IGCC does not believe that the proposed model for the interaction between the National Energy Guarantee, emissions intensive trade exposed industries and the National Electricity Market necessitates special exemptions for EITEs. At this stage it is not clear why EITEs would require exemptions under the scheme, and IGCC believes that it could add to the administrative complexity and costs associated with the operation of the scheme as a whole.

In addition, proposed contracting arrangements between generators, electricity retailers and other wholesale electricity users may face situations whereby perverse outcomes are created due to a reduction of choice for electricity suppliers.

Depending on the design of the National Energy Guarantee, a situation could be foreseen whereby the bulk of electricity supply contracts are captured by electricity retailers with liabilities under the emissions obligation of the National Energy Guarantee. To ensure compliance with the emissions obligation, the National Energy Guarantee will likely see all but the most emissions intensive sources of electricity contracted to liable entities. As a result, exempted emissions

intensive trade exposed entities will may face limited options with who they may be able to contract for supply.

With lower emissions sources of electricity locked up under the emissions guarantee, emissions intensive trade exposed entities could be limited to entering into electricity purchase agreements with high emissions sources of electricity that are not under a contract relevant to the guarantee. With limited competition remaining, contracted, supply of electricity may carry higher prices than prevail in the rest of the electricity market, creating a perverse outcome for trade industries.

The IGCC is of the view that the argument for providing an exemption for emissions intensive trade exposed industries needs to be revisited, with consideration to the impacts of such exemptions on the businesses themselves, the energy market and for consumers who are left to carry an additional burden for emissions abatement.

Offsets

As highlighted earlier in this submission, IGCC supports the inclusion of high-quality emissions offsets as a means of providing compliance flexibility under the National Energy Guarantee.

However, it is not currently possible to make a determination on whether international sources of offsets should be included in the emissions obligation, due to a lack of formalised mechanism for the generation and transfer of international units into the Australian market. As a mechanism is yet to exist, it is not possible to compare the quality of units generated under domestic schemes, such as Australian Carbon Credit Units (ACCUs), nor what impact access to an external supply of offsets may have on the Australian energy market and efforts to reduce emissions.

It also remains unclear what the supply and demand implications of the Paris Agreement will be for the pricing of international units, with no guarantee that the suppressed pricing of international units in recent years will continue once all countries start ratcheting up emissions reductions in line with the Paris framework.

At least initially, the inclusion of offsets under the emissions guarantee should focus on suitable domestically generated offsets, such as those 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.

The use of offsets should also be capped to a certain portion of a retailer's emissions liability, to provide flexibility, but also ensuring that retailers are incentivised to seek out cost-effective actions within the National Electricity Market to reduce the emissions intensity of their electricity operations.

Responses to Chapter 5 – Reliability Guarantee

Reliability of electricity supply is a key pillar in the effective performance of the National Electricity Market and can be delivered with careful planning and a key signal to the market that facilitates investment in generation infrastructure that likewise delivers electricity with at low cost and minimal environmental impact.

Existing energy market bodies provide crucial supply and demand forecasts that should be built upon and strengthened to guarantee the continued reliability of supply of electricity, while maintaining an open and competitive market amongst electricity retailers and generators.

Forecasting the reliability gap

Current forecasting services provided by the Australian Energy Market Operator (AEMO) provide a good template for how future forecasting under a Reliability Guarantee could be undertaken to provide guidance on levels of future investment required to maintain electricity supply reliability.

The NEM Electricity Statement of Opportunities and the Medium Term Projected Assessment of System Adequacy (MTPASA) reports provided annually by AEMO should form the basis of reliability projections under the Reliability Guarantee and should be adapted as necessary for this purpose.

To provide confidence to investors and companies seeking to supply new capacity into the National Energy Market to meet future reliability needs, forecasts of future capacity levels and shortfalls should be developed with as great a forward horizon as possible, while also being updated as frequently.

Some of the recent challenges that have emerged in the energy sector have been created because of too short notice being provided to market participants on the level of new investment and the types of technologies that at the market is being asked to deliver. Some of these issues have been address by the recommendations of the Finkel Review which have been already adopted by COAG.

Experiences under the Renewable Energy Target serves as an example of how short-term targets can create an uncertain investment environment, leading to boom-bust cycles in investment and the commissioning of new generation capacity.

With major generation projects requiring several years from conception, environmental and planning approvals, financial close to construction and eventual commissioning, a sufficiently large forward signal is required to make viable investment decisions.

This highlights the risks that emerge when providing the market with too narrow a window with which to plan for the commissioning of new generation capacity. The Energy Security Board should ensure that adequate forward forecast of future investment needs to maintain reliable

supply within the electricity market is provided and updated with sufficient frequency as to be responsive to market developments.

In considering when AEMO, or another market body, may seek to instigate a "trigger" for when action by market participants must be undertaken to fill an identified capacity gap, the size of that capacity gap will need to be taken into account.

Rather than setting a fixed timeframe for when a trigger is instigated, the timeframe could reflect the level of investment, the reasonable time needed to fill a capacity shortfall, and the likelihood of the market successfully filling that gap at lowest cost.

For example, the timeframe needed to fulfil an identified generation capacity gap of 100 Megawatts, that may result in changes in forecast demand, is going to be significantly different to an identified gap of over 1000 Megawatts what may result from the announced closure of a power station.

The relevant market bodies should be provided with sufficient flexibility to prompt the market to action with a timeframe that is proportional to the scale of that action.

Contract Types and Competition

Competition within the Australian retail electricity market is important to ensure customers have sufficient choice in electricity supply and innovation in how households and businesses are able to manage their electricity use and costs.

There is a risk that the types of contracts used for compliance under the reliability mechanism could have a significant impact on retailer competition. It is a reality of the electricity market that disparate levels of market power reside amongst a small number of large electricity retailers, and this is further complicated by retailers who also participate as generators within the market.

Flexibility in how compliance with the reliability guarantee, including a suitable mix of contractual arrangements that are backed by physical generation assets with those of a financial nature, is required to ensure electricity retailers are not adversely affected by the impacts of market power.

By protecting against situations where the contract market for reliability instruments is monopolised by particular market participants, the Energy Security Board can promote the emergence of an open and transparent market in which all energy market participants can be active.

Conclusions and recommendations

Australia needs an effective and credible energy and climate policy to unlock investment in new generation and address price surges for business and households. This policy mechanism has to credibly address environmental ambition in order to strengthen system wide reliability considerations.

In reviewing the draft consultation paper issued by the Energy Security Board, IGCC has sought to provide constructive feedback on the questions published for further consultation.

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.

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 Energy Security Board and with Government on these matters as consultation on the design of the mechanism progresses.