



Agriculture Industries Energy Taskforce

12 July 2018

Dr Kerry Schott AO
Independent Chair
Energy Security Board (ESB)
info@esb.org.au;

Dear Dr Schott

Re: National Energy Guarantee (Guarantee) Draft detailed design consultation paper

National Irrigators' Council (NIC), on behalf of the Agriculture Industries Energy Taskforce* (the Taskforce), is pleased to provide comment in response to the Energy Security Board (ESB) detailed draft design consultation paper around the National Energy Guarantee (Guarantee).

We acknowledge the work of the Government to introduce the Guarantee as the start of a way forward in repairing the broken system we currently face in the National Electricity Market (NEM). The Taskforce notes that it will take a multifaceted policy approach to deliver affordable and reliable power for consumers while seeking to lower emissions at least cost.

We point out again that a national policy via the Guarantee is only a part of the picture. Action is needed on network costs, competition and excessive profit margins throughout the system.

The Taskforce cautiously welcomes the Guarantee as a means of bringing some policy certainty to the energy sector. It does offer the opportunity to achieve stability through bipartisan political support and a vehicle to meet the emissions goals outlined by both the Government and Opposition. Against the backdrop of the unsustainable cost of energy faced by the agriculture sector in recent years, the food and fibre sector is also seeking certainty.

We refer you to previous submissions provided by the Taskforce on the Guarantee consultation paper (March 2018), and our most recent further submission on the Guarantee draft detailed design (Commonwealth Elements paper) (July 2018).

However we do, have concerns about elements of the Guarantee. These relate primarily to the risk

The Agriculture Industries Energy Taskforce has identified a sustainable electricity price as one that has, a price ceiling of 8 cents for electrons (R) and 8 cents for the Network (N)

that the Guarantee might (once again) provide the opportunity for the energy sector to enhance its assets and returns at the expense of consumers. The Guarantee must be a policy that reduces costs to agricultural consumers; it must not provide an excuse, or framework, for unnecessary network or generation investment, which might then attract a guaranteed return at consumers' expense.

We feel it is necessary to, again, highlight the issues that have caused Australia to be facing its current energy crisis. This is an industry where consumers' interests have been ignored, while the electricity industry enjoyed soaring profits. There has been widespread, systemic failure of National Energy Market (NEM) governance, and an absence of accountability to governments by the many NEM institutions. This has combined with a failure of regulation, with revenue/price regulation of monopolies ineffectual, and no oversight or monitoring of network profits, nor monitoring of retail margins, which has resulted in market concentration.

Energy policy failure is imposing unsustainable pressure on Australia's food and fibre producing agriculture sector, with significant flow on effects – loss of production and loss of jobs. High energy costs are also undermining many industries' capacity to compete at an international level.

Guaranteed rates of return have historically caused massive over investment by network monopolies. They have then prompted otherwise unnecessary on-farm investment as farmers try to take control of their energy costs. Professor Ross Garnaut¹ noted: *'The over investment has been large enough to show up in massive declines in total factor productivity in the utilities sector'*. The investments are also reducing the total factor productivity of Australia's energy intensive agricultural sector and wider economy.

The focus of the Taskforce has long been to achieve affordable and reliable energy and specifically, a price of no more than 8 cents for the electrons (R) and 8 cents for the Network (N) component.

National Energy Guarantee high level draft design

We note the ESB high level design proposal for the Guarantee was presented to a meeting of the COAG Energy Council in April, and agreed that the ESB should progress development of the detailed design of the Guarantee, for determination at the COAG Energy Council's meeting in August 2018.

The Taskforce recognises that the Guarantee is the key mechanism designed to provide certainty in Australia's national energy policy, and to *'integrate energy and emissions policy to encourage new investment in clean and low emissions technologies while allowing the electricity system to continue to operate reliably'*. The consultation paper goes on to note: *'Providing long-term policy confidence is critical to lowering investment risk in the National Electricity Market (NEM) and ultimately bringing down electricity prices.'*

The Guarantee is designed *'to ensure it does not undermine but rather enhances the liquidity, transparency and the level of competition in the retail and wholesale electricity markets'*.

It is of some comfort that this consultation paper includes a greater focus on affordability. In our initial submission, the Taskforce suggested affordability (and the national interest) should have at least equal status alongside the effort to reduce emissions and to secure reliability. We acknowledge the steps outlined as to how the Guarantee provides four ways to lower prices, namely:

1. By providing an integrated energy and emissions reduction policy and certainty in the mechanism to deliver the policy, the Guarantee lowers the risks on investment in new renewable and non-renewable generation capacity.
2. The Guarantee is likely to result in an increase in the proportion of generation capacity contracted (and therefore reduce the proportion that is uncontracted). This will increase supply by incentivising generators to be available at times the system most values the generation output (i.e. when spot prices are high). This is likely to reduce both the level and volatility of spot prices due to a combination of more competitive spot market bidding and the risk reduction from having more capacity contracted.

¹ Ross Garnaut (2018), *'Australia as an Energy Superpower in a Low-Carbon World'*, address to the Annual AARES Conference, Adelaide Convention Centre, 7 February.

3. The Guarantee will incentivise investment in low cost dispatchable resources, which may include intermittent renewables ‘firming up’ their capacity, for example by investing in storage. This will enable renewable generators to supply firm-capacity contracts such as swaps and caps and compete with existing dispatchable capacity, increasing contract supply and liquidity and lowering contract prices.
4. The technology-neutral nature of the Guarantee’s reliability requirement means both demand and supply-side resources can be used. By allowing demand-side resources to compete with the generation sector, the Guarantee ensures that supply-demand balance is achieved efficiently.

Notwithstanding the complexity of these issues, the Taskforce remains concerned that the reliability Guarantee might have the effect of causing higher costs to consumers. We query therefore, what safeguards might be considered to mitigate this potential risk.

While there are a number of elements of this paper focusing on competition and affordability. The key remaining input is the definition of reliability. In other words, will the required standard reflect a realistic level with reasonable cost or will it build in ‘gold plating’ of the type we have seen in the network business over the last 20 years.

We note the Guarantee’s requirements of emissions reduction and reliability requiring retailers to support a range of different generation and demand-side technologies through their contracting. The consultation paper suggests that this will result in increased contracting levels, which in turn will create deeper and more liquid contract markets, with the latter supposedly expected to reduce the level and volatility of spot prices.

This taskforce does not have the expertise to assess whether this anticipated impact is justified, we do however view with some scepticism the operation of the market to date. It has long been the Taskforce’s view that the market rules allow the system to be ‘gamed’ to maximise returns to asset owners at the expense of Australia’s competitive position.

Competitive issues

Taskforce members have highlighted in numerous submissions that Australia does not have a competitive electricity market. A key issue arises from the high level of vertical integration on the part of the major generator-retailer companies (“gentailers”). Several experienced observers have raised concerns that the Guarantee will favour vertically integrated gentailers. If so, this would further weaken retail and wholesale market competition that is already clearly inadequate in terms of constraining prices to efficient costs. The design of the scheme should increase not reduce competition. Given that emissions arise from generation, not retailing, the design should ensure vertically integrated operators are not advantaged to the detriment of competition.

The consultation paper suggests: *To ensure that a competitive market is fostered, there will be a legal requirement that market customers and generators do not unreasonably withhold any allocations for anti-competitive purposes. These requirements will be detailed further in the forthcoming Technical Working Paper on Compliance and Penalties for the Emissions Reduction Requirement. The AER may take enforcement action for breaches of these requirements.*

We look forward to further detail on such legal requirements in the Technical Working Paper that might ensure that market customers and generators are not behaving in an un-competitive manner.

Chapter 3: Emissions reduction requirement

The Taskforce has commented on the Commonwealth aspects of the emissions requirements in its ‘Commonwealth elements’ response. This comment will not focus on the level of emissions reduction built into the system. We would note also that the National Farmers Federation has made comment on this in their submission, which the Taskforce agrees with.

It is noted that the ESB has proposed, in an outline form, alternative arrangements for implementing the emissions guarantee. We welcome the fact that this alternative approach has been designed to enhance competition and that the paper specifically responded to price concerns raised by agriculture.

In theory, the outline looks sound. Subsequent detail of operation will be critical and in the longer term there should be scrutiny by the ACCC of the actual operation of the registry and its participants to ensure behaviour matches the theory.

Provisions intended to specifically ensure that vertically integrated companies are not able to use their significant market advantage to reduce competition are welcome, but again need to be carefully scrutinised as they are implemented and operating. The taskforce remains concerned about the level of market power held by large vertically integrated operators.

We also continue to be concerned about how these processes will operate, in effect, in States with limited competition. In particular, in Queensland, where most agricultural and irrigation consumers continue to have no choice of retailer.

Exempt EITE load

The Taskforce is not opposed to EITE's being exempt. However, we note that, while they are smaller and more distributed, agricultural industries can also be intensive power users and are all export exposed. That does not mean we want exemptions, indeed the sector is willing to play its part in emissions reduction. However, it is important that the burden is equitably spread.

The proposal in the paper is for non-EITE load to be scaled up by a factor that equals total system load for the purposes of the emissions reduction requirement. By definition that shifts the load onto every other electricity user. There is probably no alternative to this if emissions targets are to be met, but it highlights the fact that there needs to be tight monitoring and control over what is eligible for the exemption and the overall size of the exemption.

Section 3.4.3 Use of offsets

The Taskforce submission of March 2018 advocated the use of offsets, suggesting there should be no reason why they should be limited, as long as they could be independently audited and verified. We flagged the opportunity for the agricultural sector to participate in programs creating credits or offsets.

Carbon farming enables farmers and land managers to earn carbon credits by storing carbon or reducing greenhouse gas emissions on the land. These credits can then be sold to others, including businesses, who seek to offset their emissions. The initiative has the added benefit of encouraging sustainable farming. By maintaining certainty through clear and consistent principles and mechanisms, the agriculture sector is able to participate in the use of offsets.

In response to these issues raised by stakeholders, the consultation paper notes: *the Commonwealth Government continues to consider whether market customers should be able to use external offsets as a flexible compliance option to meet the emissions reduction requirement, and if included, whether to apply conditions, such as an overall cap on the number of offsets that could be used. If offsets are permitted, the NEL and Rules would provide details regarding their use. This would include a mechanism for linking offsets surrendered in the Australian National Registry of Emissions Units (ANREU) for the purpose of the emissions reduction requirement, to compliance calculations for market customers.*

In addition, if the Commonwealth Government set an overall cap on the number of offsets that could be used across the electricity sector, the NEL and Rules would address how to establish individual allowances of offsets across market customers in the NEM.

To be absolutely clear. The Taskforce strongly supports the ability of farmers to participate in creating offsets under clear and simple rules.

Chapter 4: Reliability Gap

In our submission to the first paper earlier this year we raised a number of concerns with the reliability guarantee and its potential to generate unnecessary capital expenditure with costs passed on to consumers. We also highlighted competition concerns with the potential for vertically integrated gentailers to exercise a dominant position in the market or the potential for generators to withhold.

We do note the explicit recognition of these type of concerns on page 13 of the paper, with points two and three of the 'four key ways to lower prices' noting that the new proposals will increase the proportion of contracted generation capacity and 'incentivising investment in low cost dispatchable resources.'

It is also noted that the paper essentially suggests that it does not expect the guarantee to be triggered.

While the commentary on the proposal provides some comfort we still have some real concerns about the practical implementation.

At the core of this concern is not knowing what the reliability requirement will be and its practical impact. As mentioned above, our sector (and our national competitiveness) continues to pay the price of reliability requirements set at unnecessarily high levels by State Governments over a number of years. It could be suggested that, at times, those network reliability targets were the result of political responses to power outages rather than balanced consideration of costs and benefits.

The proposal for publishing, some years out, reliability requirements for generation should ameliorate the possibility of knee jerk responses, but we remain nervous about what will govern the setting of the requirement.

We note the eight proposed high-level steps identified by the ESB to the reliability requirement and seek to specifically focus on the 3rd step in the consultation paper which outlines [Triggering the requirement](#): which the consultation paper describes as follows:

If a material reliability gap is identified in the forecasts, the market would be expected to react. This might take the form of investment in new capacity (eg, generation, transmission, storage or demand response) or an offer of additional existing capacity to the market.

If, in three years from the period in question, a material gap continues to exist or a new material gap emerges, then the reliability obligation will be set to trigger, and retailers will be on notice that they may have to demonstrate future compliance.

The paper acknowledges stakeholder concerns regarding attaching a regulatory requirement to a forecasting process, and suggests that the trigger for the reliability requirement will be subject to independent checks and balances to allay those concerns. We are told that '*AEMO will require the AER approve a request to trigger the reliability requirement on retailers and large users over the 5 MW threshold, and if this approval occurs, the trigger will be operative*'. And that '*.....in considering any such request, the AER would assess whether the identification of a material gap is consistent with the assessment framework set out in the National Electricity Rules (Rules) and is reasonable, based on all information available*'.

We again register our concerns with the reliability requirement where the Guarantee involves a requirement on retailers (and large power users) to enter contracts related to dispatchable resources.

While we appreciate that maintaining an adequate level of dispatchable resources is fundamental for the secure and reliable operation of the power system, we remain concerned that this requirement on retailers could ultimately result in additional costs being passed on to consumers.

We submit that the Guarantee must address the risk of the wholesale markets being over-contracted relative to likely forward demand and breaching the current NEM reliability threshold.

In our submission, earlier this year, we raised a number of issues in this respect. At this stage we are not sure these have all been covered by the revised design. They included:

- Generation constraints are responsible for only a fraction of total consumer supply outages. For example, the outage in Victoria earlier this year was due to network problems not generation constraints.
- There is substantial variation in the security value of different types of generation. This is partly recognised in the WA capacity market via its Relevant Level Methodology (RLM) set out in Appendix 9 of the WEM market rules. In the NEM context, an analogue to the RLM would be required and should recognise the fact that ageing thermal generators do not offer secure resources during extreme heatwaves when annual maximum demand is likely to occur.

This reflects the fact these facilities typically were not designed to operate at extreme ambient temperatures. In recognition of this, generators would understandably be reluctant to make forward physical contractual commitments given uncertainty over plant availability at the critical period. This could result in a significant portion of plant not being contracted in advance and giving rise to an apparent Guarantee shortfall.

At present, any capacity that is held in reserve relative to forward commitments, is available for dispatch through the spot market. If, however, a Guarantee shortfall has been declared, and new capacity has to be contracted, there would be an increase in total capacity and cost. At the same time, generators may not be able to obtain spot revenue from dispatching uncontracted capacity through spot markets.

- To the extent the Guarantee further transfers demand volume risk from suppliers to consumers, it would inefficiently raise wholesale costs overall. This is evident in some capacity market designs, most notably the WA wholesale electricity market, where there has been substantial excess generation capacity which has led to substantially higher than efficient wholesale prices almost of the entire period the capacity market design has been in place. This is recognised in the fact the WA government is currently seeking to modify the capacity market design and pricing process.²

Taking points two and three together, there appears to be a significant risk that the Guarantee restrictions on wholesale competition could transfer additional risks to consumers and increase total wholesale market costs. It is important that these risks and issues are identified and remedied in the context of a proper RIS process.

- In our previous submission, we also raised concerns about the administration and data processing requirements the guarantee was likely to generate. It is noted that in this paper there are assurances that administration will not be overly burdensome. We will watch with interest how future technical papers achieve this.

We stress again that it is vital the Guarantee does not result in another round of poorly justified CAPEX. Our long-held concern is that the 'reliability bar' in the NEM has resulted in unjustified

² <http://www.treasury.wa.gov.au/Public-Utilities-Office/Industry-reform/Wholesale-Electricity-Market-Improvements/>

infrastructure charges being passed on to consumers, in particular for consumers in rural areas where there is no network congestion.

This situation must not be allowed to happen in the generation sector. We note that the proposals in this paper attempt to minimise the capacity for the generation sector to use any position of market power to justify excessive expenditure on new infrastructure. We remain to be assured that this will be successful.

As it stands the paper does not appear to contemplate network owners being able to bid in with network solutions (ie interconnectors etc) to solve potential shortfalls. We would hope that if they were able to be involved in any 'bidding' it would be very strictly constrained.

The Taskforce does have a specific concern about the threshold level for energy users to be included in the guarantee. The current proposal of users greater than 5MW is too low. It is possible for a relatively small company with a large pump station to come in at around that threshold. The taskforce would support raising that threshold – potentially to users of 100MW or higher.

Finally, it is noted that Chapter 4 proposes that the AER will be the independent entity. While the taskforce respects the AER, we do find that, in practice, they are extremely difficult for people who are not electricity market experts to access and engage. If the AER is to take on an even wider role over their already vital role then we need to see a real focus on ensuring that industries like agriculture are able to access and engage meaningfully with the AER. In that past we have felt, we have been unable to have meaningful engagement because we do not have the resources or industry expertise held by the major power infrastructure owners.

Section 5: Governance of the Guarantee

The consultation paper notes: *The ESB's preferred option is for COAG Energy Council agreement with implementation through existing governance arrangements for the NEM. The majority of the Guarantee would be implemented through amendments to the Australian Energy Market Agreement (AEMA), the NEL and the Rules.*

Embedding the Guarantee into the broader energy governance framework would allow the mechanism to be fully integrated with the broader energy rules. This would maximise consistency between the reliability and emissions reduction requirements, reducing complexity and compliance costs for market participants.

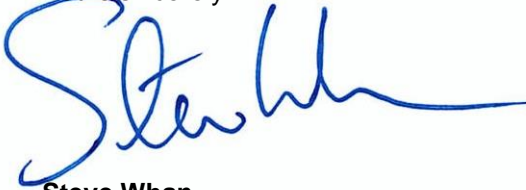
The Taskforce highlights concern regarding the lack of capacity for the market governance arrangements, and the key bodies involved, to appropriately respond to consumer concerns. Our experience over a number of years tells us that the key market bodies have been traditionally dominated by energy industry 'insiders', where rules tend to favour owners, with little consideration given to consumer concerns. It is important that governance structures are given a fresh approach that requires regulators to be mindful of the long term interests of consumers. As well as designing sound rules, it is important that the Board overseeing their administration include appropriately qualified consumer representatives.

Final comments

All policy governing the electricity market, including the final design of the NEG, must be based on the national interest underpinned by the key tenets of affordability and Australia's international competitiveness.

On behalf of the Taskforce, I thank you for your consideration of the issues detailed in this submission.

Yours sincerely



Steve Whan
CEO, National Irrigators' Council

On behalf of the members of the Agriculture Industries Energy Taskforce listed below:

- National Irrigators Council
- NSW Irrigators' Council
- Queensland Farmers Federation
- Cotton Australia
- Irrigation Australia
- Winemakers Federation of Australia
- Pioneer Valley Water
- Bundaberg Regional Irrigators
- CANEGROWERS
- Dairy Connect
- NSW Farmers
- Central Irrigation Trust