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Energy Security Board  
COAG Energy Council  
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CANBERRA ACT 2601



**Business SA**  
Chamber of Commerce  
and Industry South Australia

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Working for your business.  
Working for South Australia

Dear Board Members

I write in response to the Energy Security Board (ESB)'s request for submissions on the draft design consultation paper for the National Energy Guarantee (hereon in referred to as draft NEG).

### Executive Summary

- Business SA supports the continued development of the NEG, but it must be designed to allow for transparent costs of meeting both emissions reduction and reliability requirements to ensure that consumers pay not a dollar more than the minimum cost able to be achieved by the market.
- South Australian businesses have already borne the brunt of an electricity market which incentivised renewable development with no regard for dispatchable electricity and base-load competition concerns, which must all be addressed in the final design of the NEG.
- Having a tradeable instrument for meeting reliability and emissions requirements will avoid the highly centralist approach suggested where AEMO would run book builds with retailers to ensure reliability outcomes are met.
- A transparent instrument to ensure that if a reliability gap is forecast and not filled, that demand will be met, will ensure that if AEMO has to procure generation to meet a gap that it only pays the least cost the market can deliver.
- The draft NEG is highly complex and there is no doubt that this complexity is reducing the confidence of consumers that it will deliver cost-effective outcomes as mandated by the national electricity objective.

Should you require any further information or have questions, please contact Andrew McKenna, Senior Policy Adviser, on (08) 8300 0000 or [andrewm@business-sa.com](mailto:andrewm@business-sa.com).

Yours sincerely,

Anthony Penney

Executive Director, Industry and Government Engagement





### **Why this matter is important to South Australian businesses**

*As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:*

- At an estimate cost of \$450 million to business<sup>1</sup>, South Australia's 2016 state-wide blackout crystallised the importance of electricity reliability and set the tone for a trend towards many small businesses taking reliability issues into their own hands with back-up diesel generators, typically not the most economic nor environmentally efficient outcome for the grid at large.
- Up until mid-2015 when South Australia's wholesale electricity prices began to rise dramatically, network costs had been the primary driver of the significant increases in electricity costs over the past decade and South Australian businesses cannot afford to return to the spending patterns associated with that period which have been compounded through rising values of regulatory asset bases.
- Prior to the 2016 state-wide blackout, Business SA led a coalition of South Australian representative groups specifically calling for an independent review of the electricity market's transition to low carbon to protect affordability and reliability, and actioning the Finkel Review's recommendations must remain a priority.

### **Key Policy Points**

1. Business SA has publicly supported the advancement of the NEG to ensure there is policy certainty for a reliable and affordable electricity grid as Australia transitions towards a low carbon environment. Our comments on the draft NEG in no way conflict with our overriding desire to have policy certainty, but the NEG will have long term ramifications for the market and it is important to get the design right. This obliges us to raise genuine concerns which should not be ignored for the sake of having a new emission reduction and reliability policy implemented expediently.
2. The NEG design process should be all about protecting the long-term interests of consumers with respect to price (first component of national electricity objective), quality, safety, reliability and security of supply.

Unfortunately, the executive summary of the draft NEG does not specifically reference consumers, or their long-term interests, which needs to be front and centre in the final design.

3. Business SA is concerned that the NEG may require retailers to contract capacity too early in the piece relative to standard market practices.

The ESB needs to ensure it works closely with retailers to understand market benchmarks for how much capacity is typically hedged (either physically or by contract) at various timeframes before demand must be met to ensure that retailers are only required to meet an appropriate percentage of future reliability requirements, for example three years out.

If the NEG is designed in a manner which unnecessarily ties up retailers too far in advance, then it is more likely to entrench existing levels of competition which is particularly relevant to achieving competitive market outcomes in jurisdictions like South Australia. Secondly, how can a retailer realistically know its market share three years out from a compliance year?

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<sup>1</sup> Note the estimated result from our Blackout Survey Report has been updated to reflect additional costs reported by BHP in February 2017. Note Adelaide Brighton Cement has also reported power outage costs of \$9m for 2016 but did not isolate to specific incidents. Based on the latest available information, Business SA now estimates the total costs of September 2016's State-wide blackout to be approximately \$450 million.



If the NEG is more about ensuring reliability across the short to medium term, rather than in every dispatch interval, then the need for retailers to be fully covered with dispatchable capacity several years out is likely to place an excessive constraint on the market.

Business SA supports the ESB's aim to deliver a policy mechanism to significantly contribute to a more reliable and affordable electricity system in step with Australia's international emissions commitments, and we highlight the need for the NEG mechanism to continue to attract new market entrants.

4. Business SA notes the ESB's advice that the NEG design process needs to develop further before taking into account market concentration concerns.

Notwithstanding, we acknowledge a recent report from Western Australia's Economic Regulation Authority (ERA) which highlighted the importance of market concentration issues stating *'Synergy dominates the wholesale electricity market, controlling about 75 per cent of generation and setting electricity market prices three quarters of the time. There is limited competition and wholesale electricity prices are increasingly high and volatile. This is despite low spot prices for gas.'*<sup>2</sup>

The ERA also stated that *'From the experience in National Electricity Market (NEM) jurisdictions and the Western Australian retail gas market, the introduction of full retail contestability may be ineffective in placing downward pressure on retail prices unless a competitive wholesale electricity market exists.'*<sup>3</sup>

While Business SA recognises that the NEG consultation period will still be underway at the time the ACCC's report is expected to be finalised, 30 June, we are concerned that the NEG's design will be progressed too far in isolation of any recommendations which may emanate from the ACCC.

In the ESB's advice to COAG Energy Council on the NEG in December 2017, a whole section was dedicated to competition issues, particularly in South Australia, where you stated *'effective competition in both retailing and generation is required for the Guarantee to achieve its policy objectives at the lowest possible cost to consumers.'*<sup>4</sup>

Subsequently, the final design of the NEG should only be agreed once the ACCC's recommendations have been considered for. Recommendations from the ACCC may not ultimately impact the NEG's design, but it would be remiss of the ESB to finalise the NEG's design without ensuring how any market concentration related recommendations can run in tandem.

South Australia continues to maintain the highest average wholesale spot and futures prices in the NEM and considering our businesses have been paying significantly elevated prices since June 2015 when Alinta announced the Northern Power Station closure, affordable outcomes for consumers can no longer be delayed.

5. Unfortunately in recent years, uncompetitive contract prices have forced many businesses in South Australia onto the spot market. While new age retailers are enabling such businesses to better manage their spot exposure, including with back-up diesel generators or curtailing/shutting down load, the reality is that this approach to buying power is still very 'hands on' and takes away the attention of management from their core business.

However, if a business wants to manage on the spot market and is happy to employ the appropriate tools to do so, that should be their choice and not one that is unnecessarily removed through inflexible government policy. The primary focus of the NEG should still be to drive down contract prices, but equally it should provide enough flexibility for all size businesses, including SMEs, to operate in the spot market if they can ultimately achieve better price outcomes. While for the most part, SMEs prefer cheaper contract prices to 'set and forget' their energy exposure, the NEG should not restrict their choice to manage on the spot market.

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<sup>2</sup> Economic Regulation Authority Western Australia, '2016-17 Wholesale Electricity Market Report to the Minister for Energy', page 1

<sup>3</sup> Economic Regulation Authority Western Australia, '2016-17 Wholesale Electricity Market Report to the Minister for Energy', Page 13

<sup>4</sup> Energy Security Board, Energy Security Board Advice - The National Energy Guarantee, page 37



If the requirements of the NEG place too much of a burden on SMEs to manage, they may be forced onto higher priced contracts. Subsequently, there should be some measure of reasonable applicability to NEG requirements which should not impact below say, businesses which operate under a 5 MW load, or under a 30 MW load consuming less than 20 GW hours per annum. As a point of comparison, this measure would be equivalent to the requirements for a generator to be registered with AEMO.

6. It should be recognised that Australia's emissions reduction target is exactly that, a national target, and all jurisdictions have equal responsibility and accountability for ensuring it is met. South Australia is already generating 50% renewable energy, well ahead of Australia's 2020 target, and Business SA does not want our businesses burdened with any more than our proportionate share of the direct or indirect costs of hosting current or future renewables in South Australia, including whatever may be related to the NEG.
7. Business SA acknowledges the ESB's advice that *'while certificate revenue may support (financing decisions), any generation capacity that is not financed through a mechanism linked to either spot prices or directly to a customer's load and retail contract, does not have a strong financial incentive to be available when the physical system needs it the most.'*<sup>5</sup>

However, this does not accord with other advice in the draft NEG which points to the NEG being more about reliability than system security.

In any case, it remains likely that a certificate or some sort of tradeable instrument for either reliability or emissions reduction, or both, may actually be the optimum means of price discovery in the market to ensure the parties which can deliver both outcomes at least cost are known. If the NEG relies on non-transparent bi-lateral contracts, there is no guarantee that retailers, and ultimately consumers, will pay optimum market prices for both reliability and emissions reduction.

Having a tradeable instrument would also avoid the highly centralist and intrusive nature of what is proposed by the ESB to ensure retailers meet both reliability and emissions reductions requirements. For example, AEMO conducting a book-build with retailers may sound reasonable in theory, but in reality how is this likely to work when electricity trading is so dynamic?

The reality is that whether or not an instrument is tradeable, there is still likely to be a cost to meeting reliability and emissions reductions and consumers would rather pay a transparent cost than one that is hidden within non-transparent bi-lateral contracts.

8. Overall, the draft NEG is quite complex and feedback from our members, and more broadly, suggests this degree of complexity is reducing confidence that the design will ultimately be effective.

If the NEG was designed as a more transparent market based mechanism, it would more likely gain confidence amongst consumers as a cost-effective means of achieving necessary emissions reductions and reliability.

9. The ESB should be clearer that the NEG is only there to deliver a reliability safety net, and not specifically about incentivising generators/retailers to deliver reliability in the same manner in which an expensive capacity market might.

Likewise, the emissions reduction component of the NEG will not specifically incentivise emissions reductions on the same basis as the existing Renewable Energy Target (RET) but rather ensure that the existing trajectory of the NEM is maintained and that if not, retailers will face a specific penalty.

10. Any penalty associated with not complying with the NEG should be equivalent to any costs AEMO would incur from stepping into the market to redress. Accordingly, a transparent market based instrument would give the NEG more credibility from the perspective that any penalty costs would be equivalent to the true market costs, and not any additional costs from say, AEMO not achieving an optimum market outcome to secure necessary reliability.

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<sup>5</sup> Energy Security Board, draft design consultation paper for the National Energy Guarantee, page 13



11. If the NEG is designed to ensure facilitation of reliability and emissions reduction outcomes, how will it be designed to ensure that AEMO market interventions in jurisdictions like South Australia are ultimately withdrawn?

Wind power beyond 1,200 MW of generation is currently being spilled in South Australia and Business SA is quite conscious of the market costs of these types of interventions, and if indeed they are temporary, we would like some public acknowledgement by the ESB that this is a scenario they are looking to address? If not through the NEG, then otherwise.

12. With recent moves by the United States to impose steel and aluminum tariffs, it will be particularly important for the ESB to carefully consider NEG outcomes on emissions intensive trade exposed industries.
13. Business SA supports the use of international carbon offsets for meeting NEG requirements, providing they are strictly limited to legitimate foreign carbon reduction schemes such as the EU emissions trading system (EU ETS).
14. Responding to your question about how interconnectors should be treated, the ESB should make comment on the likelihood that a new interconnector between South Australia and New South Wales will improve the ability for South Australian retailers to access firm hedges from interstate, particularly in light of your comments that *'participants can hedge inter-regionally in the manner described above currently, but that many participants don't due to limitations with inter-regional trading. Therefore, to the extent that inter-regional hedges are currently used, such contracts should also be eligible for use to meet a reliability requirement under the Guarantee.'*<sup>6</sup>

Better facilitating inter-regional hedges will be an important consideration for the level of competition that can be delivered to South Australian consumers, including businesses.

15. Business SA acknowledges the lack of discussion about how either Western Australia or the Northern Territory will have to meet their proportionate share of reducing Australia's greenhouse gas emissions through to 2030 and beyond. It has already been the case that jurisdictions such as South Australia have shouldered a disproportionate share of generating intermittent renewable energy to reduce emissions and we request more detail on how the contributions of non-NEM jurisdictions, particularly Western Australia, will be treated.

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<sup>6</sup> Energy Security Board, draft design consultation paper for the National Energy Guarantee, page 46