AGL Energy Limited
ABN: 74 115 061 375
Level 24, 200 George St
Sydney NSW 2000
Locked Bag 1837
St Leonards NSW 2065
t: 02 9921 2999
f: 02 9921 2552
agl.com.au

Dr Kerry Schott AO

Chair, Energy Security Board

Submitted by email: **info@esb.org.au**

12 September 2018

Consultation on National Energy Guarantee Amendments

Dear Dr Schott,

AGL Energy (**AGL**) welcomes the opportunity to make a submission in response to the Energy Security Board's (**ESB**) Consultation on National Energy Guarantee Amendments (**Amendments Paper**).

AGL is one of Australia's largest integrated energy companies and the largest ASX listed owner, operator and developer of renewable generation. Our diverse power generation portfolio includes base, peaking and intermediate generation plants, spread across traditional thermal generation as well as renewable sources. AGL is also a significant retailer of energy, providing energy solutions to around 3.5 million customers throughout eastern Australia.

In addition, AGL is continually innovating our suite of distributed energy services and solutions for customers of all sizes. These behind-the-meter energy solutions involve new and emerging technologies such as energy storage, electric vehicles, solar PV systems, digital meters, and home energy management services delivered through digital applications.

We note that concurrently to this consultation, the ESB has also released a Reliability Requirement Pre-Condition Options Paper, which included further detail on three proposed alternatives to the design of the reliability requirement. AGL has provided a separate response to issues raised in that paper.[1]

We also note recent developments in relation to the policy of the Commonwealth Government. These include comments to the effect that the Government will not proceed with the National Energy Guarantee (**NEG**) but will proceed with some element of the reliability guarantee.[2]

While these developments create significant uncertainty for energy market participants, the underlying issues that the NEG was looking to address have not disappeared. We therefore consider it useful at this time to reiterate the requirement for long-term policy settings to address climate change, maintain system reliability and security, and place downward pressure on wholesale prices by increasing supply and stabilising long-term investment signals.

A long-term approach to energy policy

The piecemeal introduction of carbon reduction and renewables policies has produced unintended consequences for wholesale energy markets, as price signals and incentives for development have shifted over time. The lack of a long-term mechanism to address emissions reductions that has bipartisan political

[1] AGL submission in response to the National Energy Guarantee Reliability Requirement Pre-Condition Options Paper, available at https://thehub.agl.com.au/articles/2018/09/submission-in-response-to-the-neg-reliability-requirement-pre-condition-options-paper

[2] See, for example: Simon Benson, "NEG 'dead' as PM sets new course", *The Australian*, 8 September 2018, 1,6

support has been a significant contributor to increased risks and costs for energy market participants and has had material impacts on the Australia energy sector overall.

Indeed, recent movements in the forward price curve of energy can be directly correlated to political uncertainty. Similar movements can be seen historically; where changes to policy settings have been announced unexpectedly or energy market participants have make significant decisions without providing adequate notice, such as closing thermal plant, prices have increased.[3]

AGL has therefore consistently asked for governments and policy makers to bring a long-term vision to the energy market, and we have led by example. In 2015, AGL published its Greenhouse Gas Policy, outlining commitments to decarbonisation and modernisation of our generation fleet by 2050, no investment in new coal fired generation in Australia without carbon capture and storage technology, establishment of end of life closure dates for our three operating coal plants, innovative renewable investment, and constructive engagement on energy and climate policy.

Following this policy, we have clearly signalled the anticipated closure dates for our thermal power stations, starting with Liddell in 2022, with clear associated transition plans for replacement generation and rehabilitation plans that take into account local communities and economies.[4] These public commitments have allowed stakeholders to have open and frank discussions regarding the future composition of the energy system and develop policies accordingly.

The transition of the energy market must be supported by a framework that aims to minimise negative impacts while simultaneously maximising opportunities for net positive impacts from the transition for all stakeholders.

Our approach to power station closure is guided by these aims as we develop and refine our transition framework, but what is missing from this framework is long-term certainty from the Government on the trajectory of decarbonisation in the electricity sector and the settings under which that will occur. This uncertainty drives up wholesale costs, leads to the inefficient deployment of capital, delays investment, and impacts on the ability to assist in the optimal transition for communities experiencing change.

We believe that greater policy vision and longer planning timeframes will lead to more comprehensive engagement with communities, businesses, and customers, with better outcomes for all parties.

Integrating energy and emissions policy

In seeking to establish this long-term certainty, AGL has therefore been a strong advocate for the ESB's proposed approach to integrate emissions reductions policy with energy policy through the draft design of the NEG, and to establish a clear trajectory and policy mechanism to reduce Australia's greenhouse gas emissions over time.

Above all, we consider that the transition to a sustainable NEM that utilises substantial amounts of renewable energy must be orderly. Australia is in need of a long-term carbon policy that drives investment in low-emissions sources and can steer the electricity sector smoothly through the process of replacing aging thermal plant with less emissions-intensive generation, while also meeting other electricity sector objectives.

The energy sector has an important role to play in meeting Australia's international commitment to reduce greenhouse gas emissions. The generation of electricity is responsible for a third of Australia's total greenhouse gas inventory, and decarbonisation of other sectors, such as transport and manufacturing, rely

[3] See Nelson et. al., Decarbonisation and wholesale electricity market design, *Australian Journal of Agricultural and Resource Economics*, July 2018, available at: https://onlinelibrary.wiley.com/doi/full/10.1111/1467-8489.12275

[4] See AGL's NSW Generation Plan, available at https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2017/december/agl-announces-plans-for-liddell-power-station and AGL's 2017 Rehabilitation report, available at https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2017/august/agl-rehabilitation-report

heavily on clean energy sources becoming available. This is an imperative that will not disappear over the short-term.

Fortunately, numerous studies have shown that the cheapest form of new generation build is increasingly likely to be large scale wind and solar assets, which can run at a lower short-run cost and contribute to lower wholesale prices if integrated well into the wholesale market. Indeed, the ESB's own modelling on the NEG suggested that this type of investment would contribute to driving down wholesale prices.

An orderly transition to renewables

The key to lowering wholesale prices is therefore taking a long-term approach to the integration of renewables in an orderly way. The NEG is primarily a mechanism to provide certainty on investment during a period of transition to lower emissions generation sources, with an associated safeguard to ensure system reliability – its design should therefore focus on meeting this aim.

A component of this transition requires system reliability to be maintained with increasing penetrations of intermittent generation sources. For this reason, we also support the objective of the NEG's reliability obligation, which is to ensure that investment in new generation contributes to system reliability and resilience. Even so, we note that there are no current forecast capacity shortfalls that would trigger the reliability guarantee, and that a market that was adequately responding to long-term price signals would be unlikely to require further intervention in that regard, as competitors would have sufficient information to make arrangements to address forecast shortfalls in an efficient manner.

With that in mind, we consider that the reliability guarantee framework is not required to be progressed in the absence of a policy to drive further investment in intermittent renewables. In the absence of an emissions obligation, other reliability mechanisms or market reforms are likely to exist that may allow reliability targets to be met at lower cost to customers and at lower risk of market intervention. Similarly, policy mechanisms that are aimed at driving liquidity and transparency in wholesale markets may be more appropriate to consider separately to the NEG, as they have different broader objectives to stimulating new investment.

The electricity sector has already experienced significant disruption over the last decade, most notably as a result of declining demand that was poorly forecast, and the disorderly exit of thermal plant replaced by subsidised large-scale renewables. This disruption has led to numerous enquiries including the Finkel Review (principally addressing security and reliability) and the ACCC's Price Inquiry (principally addressing price), which have provided a number of recommendations for reform, many of which are already well progressed.

In our view, further challenges are likely to emerge, which will test the operation of the market. Faced with these challenges, the objectives of security, affordability, and sustainability in a carbon-constrained future should be met at least cost and with minimal impact on the operation of markets.

Next Steps

We are therefore generally supportive of the draft legal and regulatory framework for the NEG, insofar as it sets out a genuine attempt at setting a long-term pathway for how participants must operate in the energy sector. The design of the NEG was undertaken with a significant number of diverse stakeholders, with almost universal agreement that the framework (regardless of the emissions ambition set by Governments over time) would be more useful than not having a policy at all.

Indeed, we consider, as the ESB also outlined in their modelling, that a do-nothing policy will be more harmful for customers over the long term, and are therefore hopeful that at some stage in the near future, the integration of emissions and energy will again be considered by the COAG Energy Council.

When this occurs, we consider that existing elements of the NEG, including proposed drafting of amendments to the NEL as considered by this consultation, will again be put forward to stakeholders. At that time, AGL will provide detailed feedback on the particulars of the draft bill as provided.

In the interim, we remain committed to supporting policy that provides clear long-term investment signals for the electricity sector in terms of expected commitments to reduce emissions. Where this trajectory may produce unintended consequences, for example, in terms of system reliability, we support further reform that is targeted to balance the outcomes required, but not at the expense of the principal aims of providing investment certainty within a long-term aim of decarbonisation, and not at any undue cost to customers.

We are hopeful that State and federal Governments will work collaboratively in the future to achieve these aims for the benefit of customers, the environment, and the broader Australian economy.

Should you have any questions in relation to this submission, please contact Aleks Smits, Manager Policy & Research on 03 8633 7146, or myself on 02 9921 2516.

Yours sincerely,

Dr Tim Nelson

Chief Economist