

The National Energy Guarantee (NEG) – new details emerge

In a Nutshell

Following consideration of responses to its February 2018 consultation paper, the Energy Security Board (**ESB**) has recently released its high level design proposal for the National Energy Guarantee (**NEG**). Simultaneously, the Commonwealth Department of the Environment and Energy (**DEE**) has released a paper further detailing the proposed Commonwealth design elements of the NEG.

Having reviewed the updated proposals for the NEG's design, on 20 April 2018 the Council of Australian Governments Energy Council (**CoAG EC**) reached an agreement that the ESB should further progress the detailed design of the NEG. The ESB will now consult with federal, state and territory governments on the specific details of the design, with the final design being expected to be released in the lead up to the next CoAG EC meeting in August 2018.

What we knew

Finlaysons has been closely following the release of details surrounding the NEG's design. See our previous alerts from [November 2017](#) and [March 2018](#).

Context

Renewable electricity generation, such as wind and solar, has played an increasing role in Australia's energy generation mix of late, and continues to assist Australia to meet its international obligations to reduce emissions under the Paris Agreement. At the same time, less intermittent generators – such as coal fired power stations – have, or are predicted to be, retired out of operation.

As the electricity 'spot' price fluctuates depending on supply and demand, a market that is highly reliant on intermittent electricity generation may be subject to an increased number of price spikes, for example, when supply is low during times when the wind is not blowing or sun is not shining. Frequent price spikes will increase the cost of electricity for Australian commercial and residential consumers.

This has been reported as being a large concern for many consumers, and the highly-politicised issue is now being commonly referred to as the energy policy 'trilemma' – the need to maintain the affordability and reliability of energy while simultaneously reducing emissions.

In October 2017, the Commonwealth Government announced the NEG as its proposed way to tackle this concern. The NEG will require electricity retailers (**retailers**) to meet separate targets for **reliability** and **emissions**. Specifically, the NEG requires retailers to:

- either own or contract a minimum amount of 'dispatchable energy' to meet reliability targets; and
- either buy or contract electricity that would allow them to achieve a set level of emissions per year.

The NEG design provides retailers with the discretion to decide what energy mix they will apply in order to meet targets. It is envisaged that retailers will support, through their contracting, investment in facilities that maintain the reliability of the power system while concurrently reducing emissions. This discretionary element acts as an incentive for the market to determine how best to achieve both targets at the lowest possible cost, thereby keeping electricity prices as **affordable** as possible.

New details

The ESB's High Level Design Document and the DEE's paper provide updated insight into how the NEG's reliability and emissions targets are envisaged to be administered and enforced. It should be noted that these papers are interim proposals and specific details of the NEG design are not yet finalised.

Reliability

Under the proposed NEG design, the Australian Energy Market Operator (**AEMO**) will forecast from ten years out whether a 'reliability standard' is likely to be met in each National Electricity Market (**NEM**) region. If it will not be met, AEMO will forecast the size of the NEM region's reliability 'gap' and inform the market that this pending gap exists.

The market is expected to react by either:

- (a) investing in new capacity in that NEM region, for example, by building new generators; or
- (b) offering additional existing capacity to the market in that NEM region, for example, by increasing the capacity of existing generators.

If the gap continues to exist three years out – or a new gap emerges, for example, if a generator gives notice that it intends to close – then a 'reliability obligation' will be set to trigger. Retailers that operate in the NEM region where the gap exists will be put on notice that they may be expected to demonstrate future compliance. Retailers must ensure they enter into sufficient 'qualifying contracts' for dispatchable energy during system peak demand at the time of the forecast reliability gap.

If the gap continues to exist one year out, AEMO itself will procure the remaining necessary resources to effectively close the gap. AEMO will then assess retailers' compliance with their NEG obligations. If retailers are deemed to have not met their reliability obligations, for example by not entering into sufficient 'qualifying contracts', penalties will be assigned. Penalties will include (at least some of) the cost that AEMO incurred while procuring the necessary resources to close the gap.

Emissions

The Government has set the emissions reduction target to a 26% reduction on 2005 levels by 2030 in order to comply with Australia's commitments under the Paris Agreement.

Under the proposed NEG design, the Government will set 'electricity emissions targets' for 10 years from 2021-2030. In

2025, updated targets for 2030 to 2035 would be set. In 2030, updated targets for 2035 to 2040 would be set and so on every five years. The targets will be expressed as average emissions per MWh, which retailers will be required to meet. State and Territory Governments may also set targets outside the NEM Framework.

Retailers will be able to use existing contracts, or enter into new ones, to obtain the right to assign generation and any associated emissions for the purpose of achieving electricity emissions targets. Retailers will submit to the National Greenhouse Energy Reporting Scheme (**NGERS**) the volume of output from a generator to which they have obtained the rights through contract. Generators, under their existing obligation, will also report to NGERS energy production and associated emissions. NGERS will use the reported figures to assess a retailer's compliance.

If retailers exceed their requirements in one year, they will be permitted to carry forward their overachievement. If retailers fail to comply, they will be able to defer compliance. Flexible compliance options are intended to allow retailers to manage variables such as unexpected generator outages and potential delays to the entry of new generators.

Despite the flexible compliance options, the NEG is designed so that if retailers fail to meet targets, they may be subject to a range of compliance actions including administrative undertakings, infringement notices, enforceable undertakings, civil proceedings and suspending or revoking authorisation.

There are certain exemptions proposed and finer details can be found by reviewing the ESB's report located [here](#).

Next steps

The ESB will continue to lead the detailed design work on both the emissions and reliability mechanisms and will continue to consult with Commonwealth and State Governments to finalise the design of the NEG.

The final design is expected to be released in the lead up to the next CoAG EC meeting in August 2018.

Finlaysons will continue to release further updates as new information comes to light.

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