The NEG: Certainty in Australia at last?

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The Australian renewable energy industry has been craving regulatory certainty. A solution could finally be close, with an energy council session scheduled for 10 August (2018) to vote on the final design of the Federal Government's new policy – the National Energy Guarantee (NEG).

But market participants have concerns over onerous complexity, pervasive long-term policy uncertainty and its restrained renewables ambition.

Herbert Smith Freehills partner David Ryan tells *IJGlobal*: "The most positive result that can come from the August meeting of governments is a unified and bipartisan position on the future approach to emissions and electricity system reliability, and an agreed time frame for implementation."

But while some Liberal government states like Tasmania and New South Wales have been broadly in support of the NEG, Labor governments such as Victoria's have voiced major concerns.

The NEG scheme consists of two components:

- Emissions Guarantee
- Reliability Guarantee

The onus to comply with the NEG is placed on the energy suppliers and large power users in Australia, not the generators.

Some modelling behind the final design has just been released by consultancy ACIL Allens on 1 August and the industry's eyes are poring over it.

Emissions Guarantee

Energy project market participants say that the key areas requiring certainty are the emissions target (and how and when this can be revised) and details of how the emissions and reliability aspects will actually work in practice.

The expected target for reduction in carbon emissions is 26% by 2030 (against 2005 levels). Renewable energy projects in the country's existing deal pipeline are already due to deliver this reduction, critics say. The 26% target is also lower than some states would self-impose, and also not sufficient for meeting the Paris Climate 2030 agreements.

Ryan said: "If the target is modest, then there is no separate emissions incentive to develop renewable generation projects – only the fact that renewables are now directly competitive with coal and gas-fired generation on pure cost terms."

When that NEG target would come up for review seems to be a moving mark. Energy Minister Josh Frydenberg had indicated in late July that the review could be after five years.

Local fund manager Palisade Investment Partners, through its Palisade Renewable Energy Fund, has invested in renewables projects equity at late-development stage or in operations. The NEG should mean "business as usual" for the renewables fund, Palisade investment director Karen Gould says.

But Gould adds: "A positive outcome would be for the NEG to be adopted with baked-in annual reviews of future emissions targets and without any impediments to more ambitious state-based schemes. The resulting policy stability and potential for increased long-term ambition would spur further investment in renewables beyond the significant investment opportunities underpinned by the existing Renewable Energy Target."

There would be emissions validation requirements, registering of contracts and retailers will have ways of trading surplus emissions with those operating below the maximum.

The finalised NEG should unveil these requirements in all their complexity for investors, financiers and retailers to grapple with.

Onerous compliance costs would favour the largest and most vertically integrated suppliers.

Reliability Guarantee

The reliability guarantee component encourages suppliers to contract and invest to maintain energy system reliability.

This component of the NEG will dictate for regions the minimum level and types of dispatchable capacity required.

If shortfalls in energy demand are forecast for three years ahead, then reliability obligations would be triggered on the suppliers and they must enter into contracts to cover their share when the gap is forecast. There is due to be a dual compliance measure for output and availability, with fast-start and slow-start technologies both in the structure.

Ryan said: "There is a risk that this is an overly complex arrangement that will simply default to a central-procurement model akin to the existing reserve trader mechanism in the National Electricity Rules – a blunt and inefficient mechanism that relies on high-priced demand response."

However one large infrastructure fund manager says there is some hope that the increased focus on large scale or distributed demand response and dispatchable generation strategies might create new investment opportunities, especially in distributed energy infrastructure.

Renewable generation projects

Renewable investments under the Renewable Energy Target (RET) scheme are expected to be grandfathered from 2020 and continue to earn certificates until 2030, as is currently legislated.

Though unconfirmed, the NEG policy seems open to permitting renewable energy projects to concurrently generate renewable energy certificates (RECs) and contribute towards retailers' emissions guarantee.

There could be some feed-through impact of the NEG for investors and lenders in Australia's renewable energy generation projects.

Ryan said: "There is no clarity on how the future contracting of renewable projects by retailers will accord with the cash flow certainty and tenor expectations of investors and financiers."

Lenders meanwhile take a long-term industry view into account when modelling, and the government's ability to change the emissions target in several years could be cause for caution. Herbert Smith Freehills partner Elizabeth Charlesworth said: "The reliability aspect of the NEG is similarly uncertain and project financiers will not be minded to be optimistic in their assessment of how a particular project will financially benefit from a reliability perspective over a 20-30 year project life."

With an unambitious emissions reduction target of 26%, the availability of power purchase agreements (PPAs) should be unchanged. But if the target were higher, retailers could be compelled to contract additional low-emissions generation.

Palisade's Gould said: "The NEG should further encourage retailers and large electricity users to write long-term PPAs, especially if there is scope for a more ambitious emissions trajectory to be set in the future."