



SUBMISSION

Victorian Renewable Energy Auction Scheme

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The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

About this submission

The Victorian Government has recently announced a range of policy measures that are aimed at dealing with the challenges presented by climate change. Encouraging the take-up of low-emission vehicles in Victoria, the Take 2 Pledge program and the expansion of programs such as the Victorian Adaptation and Sustainability Partnership (VASP) initiative, are all positive developments that serve to demonstrate the constructive role that Victoria can play in this policy space.

However, the Victorian Government has not demonstrated the need for a Victorian renewable energy target (VRET) and there was limited, if any, consultation on the appropriate size of the target. Further, fundamental details that are crucial to the operation of the VRET policy have not been put forward for effective consultation.

The Business Council of Australia's submission therefore reinforces the importance of a coherent national climate change and energy policy framework, highlights the specific aspects of the VRET that require further consultation and outlines some of the significant risks posed by the introduction of the proposed VRET.

Key recommendations

► *Policy consultation should be comprehensive and effective*

The Victorian Government should adopt a best practice approach when creating new regulations, including the use of a comprehensive cost-benefit analysis for the introduction of the VRET. In particular, the Victorian Government has not effectively consulted on the specific VRET target of 25 per cent by 2020 and 40 per cent by 2025.

► *Energy and climate change policies should be nationally consistent*

The Victorian Government should ensure that the VRET is consistent with the existing federal Renewable Energy Target (RET). State-based renewable energy targets, such as the VRET, only serve to increase the cost of renewable energy projects that are being built under the national scheme and further distort Australia's electricity markets.

► *The VRET should seek to avoid creating distortions with the federal RET*

The Victorian Government should not pursue a policy that would see it operating in the market for large-scale generation certificates (LGCs), as such an approach could significantly distort the operation of the federal RET. The introduction of the VRET should not proceed until the long-term interaction between the VRET and the RET is properly considered.

► *Victoria needs a managed transition away from coal-fired electricity generation*

There has been insufficient discussion about the effect of the VRET on Victoria's current electricity generation mix. Given the profile of Victoria's coal-fired generation fleet, a more managed transition policy would seek to minimise the risks of this transition on system security and individual communities throughout Victoria.

► *Use transparent government-funding and an established administrator*

The VRET should be funded through the Victorian Government's budget so as to minimise increases to electricity prices and enhance accountability for the VRET policy. An already-established entity that has experience in managing schemes like the VRET should be utilised, instead of creating a new body or imposing administration of the scheme on electricity distribution or transmission businesses.

Integrated energy and climate change policy

Unconstrained climate change would have serious economic, environmental and social consequences for Australia. The 21st Conference of the Parties meeting in Paris in December 2015 reached a historic agreement (Paris Agreement) to limit global temperature rises to 'well below two degrees Celsius'. To achieve this will require deep global emissions reductions with most countries, including Australia, eventually reducing net greenhouse gas emissions to zero.

Australia needs a suite of durable climate change policies that are integrated with broader energy policy and are capable of delivering Australia's emissions reduction targets, at lowest possible cost, while maintaining competitiveness and growing Australia's future economy.

A suite of integrated energy and climate change policies should:

- be national and durable wherever possible, driven by bipartisan support
- be capable of achieving our committed emission reduction targets at lowest possible cost
- be scalable to meet future emission reduction targets while managing risk and uncertainty
- be flexible in the face of changing technology costs and consumer preferences
- be investable across all sectors and time horizons and provide confidence that long-term investment decisions can be made and adequate returns earned
- facilitate well-functioning energy markets, security of supply and cost effective energy delivery
- regain our energy comparative advantage
- support domestic abatement wherever it is efficient and internationally recognised, to drive transformation of the Australian economy
- make use of internationally recognised abatement from overseas to ease the transition and costs
- prevent the unnecessary loss of competitiveness by Australia's trade exposed industries and be cognisant of the second-order effects of the chosen policy suite across all sectors of the economy
- avoid disproportionate impacts on vulnerable people and low-income households and provide assistance if necessary
- assist the successful transition of communities that are especially vulnerable to economic shocks or physical risks.

Key issues

Lack of public consultation on key elements of the VRET

The Victorian Government has not effectively consulted on the VRET target of 25 per cent by 2020 and 40 per cent by 2025. Previous consultation only discussed the concept of a Victorian renewable energy target, without a specific target being proposed. Now that the Victorian Government has decided on a target, consultation has immediately progressed to the design of the auction scheme, not allowing any consultation on the consequences of the specific target.

The Business Council is also concerned that in the recently held public consultation sessions, it was indicated that the VRET will become enshrined in legislation by autumn 2017. This timetable has apparently been locked-in, despite important elements of the VRET policy framework not being put forward for effective consultation.

The following information gaps are particularly concerning:

- Critical details about the operation of the VRET have been left undetermined at present, such as how the Victorian Government will manage the federal large-scale generation certificates (LGCs) for VRET projects commissioned pre-2020. In addition, 2025 is less than 10 years away (which is a relatively short time horizon in the context of new infrastructure development) and many details on the operation of the 40 per cent target still remain unclear.
- No modelling has been provided to indicate the costs that will be incurred in administering and paying for the VRET scheme. As the VRET cost recovery pass-through mechanism proposes that electricity customers pay for the scheme via higher electricity prices, the specific retail price impacts of the VRET should be clearly explained to the Victorian public, along with any modelling that was undertaken.
- No modelling has been provided on the 4000 jobs that the VRET policy is intended to create. For example, whether these jobs will be permanent jobs and how many Victorian jobs could be lost as a result of the VRET are two issues that have not been put forward for public consideration.

The Victorian Government should therefore consult further with interested parties on these issues, including releasing a comprehensive cost–benefit analysis for the proposed scheme.

National policy and legislation as a preferred approach

In recent years, Australia's climate change policies have been largely uncoordinated and inconsistent with broader energy policy; poorly costed; and, at times, have operated in conflict with each other. At the height of this policy flux there were over 200 government programs aimed at addressing climate change.¹

¹ R Wilkins AO, *Strategic Review of Australian Government Climate Change Programs*, Department of Finance and Deregulation, Canberra, July 2008.

Renewable energy targets are expensive tools to reduce Australia's emissions. In 2014, ACIL Allen estimated that the cost of reducing emissions under the federal RET was between \$35 and \$68 per tonne of CO₂e.²

The VRET of 25 per cent by 2020 and 40 per cent by 2025 is proposed to operate alongside the federal large-scale renewable energy target, which requires an additional 33,000 gigawatt hours of large-scale renewable electricity generation across Australia by 2020. The Business Council has consistently emphasised the importance of avoiding state-based policy divergence in national markets such as electricity.

Incentivising investment in renewable energy within Victoria will simply add to the cost of achieving the federal RET at 2020. The 2020 VRET target is specifically designed to ensure higher-cost projects are built in Victoria rather than enabling the most cost-effective projects to be built across the nation as part of the federal RET policy framework. Post-2020, Victorian renewable energy projects will be additional to the federal RET and, as noted above, this will translate to relatively high-cost emissions abatement.

If the Victorian Government wants to make an increased contribution to Australia's emission-reduction challenge and avoid inflating the cost of renewable energy projects, it should look to drive national, integrated energy and climate change policy through the COAG Energy Council.

Avoiding distortions to the federal RET policy framework

The Business Council is supportive of the Victorian Government's proposal to exempt emission-intensive trade-exposed companies (as defined under the federal RET) from paying VRET scheme costs. Such an exemption is vital to prevent the unnecessary loss of competitiveness by Victorian businesses and minimise distortions between the VRET and the federal RET.

However, the Business Council is concerned about other potential distortions the proposed VRET could have on the federal RET.

Like Victoria, a range of jurisdictions across Australia (South Australia, Queensland and the Australian Capital Territory) have committed to (or are considering committing to) aspirational or legislated renewable energy targets that are more ambitious than the federal RET. If state-based renewable energy targets lead to the construction of more renewable energy projects than are needed to meet the federal RET, this could render some renewable energy projects financially unviable if the price of LGCs falls dramatically in an oversupplied market.

If the Victorian Government is to proceed with the VRET scheme as articulated in the consultation paper, the Victorian Government should not become a participant in the LGC market as this could further distort the operation of this market. Market participants bidding into the Victorian scheme should retain any LGCs and the price risk of these instruments. This approach would minimise the risk that the federal scheme could be over or under built.

² ACIL Allen Consulting, *RET Review Modelling: Market Modelling of Various RET Policy Options*, August 2014.

Any increased risk resulting from the interaction of the federal RET and VRET schemes will increase the cost of delivering both schemes. The introduction of the VRET should not proceed until its interaction with other state-based renewable energy targets (and with the federal RET) is properly modelled and this modelling is released for further consultation.

Transitioning to a lower-emission economy should be gradual and orderly

The Business Council is very concerned that there has been no discussion about the impact the VRET will have on existing electricity generation assets.

The recent experience in South Australia demonstrates the tensions that can arise as the market moves away from emissions intensive generation and towards lower emission generation. South Australia's price volatility is a result of a variety of factors including the large penetration of intermittent renewable energy; the withdrawal of thermal capacity (coal and gas) as a result of low energy prices over the last few years; the upgrade of the transmission interconnector; the availability of gas; and the cost of gas-fired generation.

Australia needs to manage the transition away from emissions intensive generation in an orderly manner that supports capital decision making and ensures system reliability at lowest possible cost to customers.

If the Victorian Government pursues a rapid increase in renewable energy generation without a broader plan to transition Victoria away from its current generation mix, the outcome could be higher and more volatile wholesale electricity prices.

These risks have been exacerbated by the Victorian Government's recent decision to legislate a permanent ban on the exploration and development of all onshore unconventional gas in Victoria. Highly efficient, combined-cycle gas turbines produce one-third of the emissions of brown coal-fired electricity generators. Gas-fired power stations will also have a vital role to play in providing lower emission electricity at times when wind and solar resources are unavailable. Without access to competitively priced gas this transition will be both riskier and more expensive.

Using transparent government-funding and an established administrator

The operation of the VRET will increase the cost of the Victorian electricity system.

The Victorian Government has stated that the VRET is primarily a job-creation policy. Funding for the VRET should therefore be sourced from the Victorian budget. Such an approach means that Victorian taxpayers can more easily weigh up the cost of the VRET policy against the long-term job creation that is achieved as a result of the policy being implemented.

In terms of who should be charged with administering the VRET, the Business Council considers that establishing a new body or tasking an existing electricity distribution or transmission business with the role is a potentially costly and risky approach. To ensure the VRET is administered by an appropriately skilled and already-established entity, a body such as the Clean Energy Regulator should be considered.

Conclusion

This submission identifies a range of uncertainties and concerns that the Business Council has identified with the VRET policy proposal. Although the Business Council's preferred approach is for the Victorian Government to not proceed with the introduction of the VRET, as a second-best alternative, the Business Council considers more detailed consultation should be undertaken on the aspects of the VRET that have been highlighted in this submission, particularly the interaction of the VRET with the federal RET.

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