



DEPARTMENT OF PLANNING, INDUSTRY & ENVIRONMENT

Energy Security Safeguard

Overview of the position paper



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Part A: An overview of the Energy Security Safeguard

1. The NSW Energy Security Safeguard

In November 2019, the NSW Government (the Government) announced the creation of the Energy Security Safeguard (the Safeguard) to incentivise the rollout of cost-effective energy savings and peak demand reduction measures. The Safeguard includes two separate schemes:

- an Energy Savings Scheme (ESS) running until 2050, with an energy savings target gradually increasing to 13% by 2030 and an expanded set of eligible activities
- a new Peak Demand Reduction Scheme (PDRS) to support activities that reduce demand at peak times, including flexible demand response.

The second emergency COVID-19 response bill package, passed by Parliament in May 2020, amended the NSW *Electricity Supply Act 1995* (the ES Act) to establish the Safeguard and extend the ESS to 2050. Aligning with the ESS, the Government intends to legislate the PDRS to run until 2050.

This position paper sets out the Government's position on key issues for the design, implementation and administration of the Safeguard.

2. Safeguard targets, penalties and compliance periods

2.1 Energy savings and peak demand reduction targets

The Government will increase the energy savings target of the ESS from 2022, reaching 13% by 2030. The target will then remain at 13% until the end of the scheme in 2050.

The peak demand reduction target for the PDRS will commence at 0.5% for the 2022–23 compliance period, gradually increasing to 10% by 2029–30. The target will then remain at 10% until the end of the scheme following the 2049–50 compliance period.

Table 1 sets out the targets for both schemes.

Table 1 Safeguard targets from 2022 to 2050

| Year | ESS target (%) | Compliance period | PDRS target (%) |
|--------------|----------------|--------------------|-----------------|
| 2022 | 9.0 | 2022–23 | 0.5 |
| 2023 | 9.5 | 2023–24 | 1.0 |
| 2024 | 10.0 | 2024–25 | 3.0 |
| 2025 | 10.5 | 2025–26 | 5.5 |
| 2026 | 11.0 | 2026–27 | 7.5 |
| 2027 | 11.5 | 2027–28 | 8.5 |
| 2028 | 12.0 | 2028–29 | 9.5 |
| 2029 | 12.5 | 2029–30 | 10.0 |
| 2030 to 2050 | 13.0 | 2030–31 to 2049–50 | 10.0 |

Under these settings, the Safeguard is expected to deliver a net economic benefit for New South Wales of \$1.2 billion by 2040. Table 2 summarises the cost–benefit analysis. Households and businesses choosing to implement energy saving and peak demand reduction projects are expected to save an additional \$3.6 billion on their bills between 2022 and 2040.¹

Table 2 Summary of the cost–benefit analysis

| Present value of incremental costs and benefits to 2040 | ESS | PDRS |
|---|----------------|---------------|
| Scheme costs | | |
| Government costs (\$m) | –\$50 | –\$42 |
| Regulatory costs (\$m) | –\$377 | –\$192 |
| Total costs (\$m) | –\$427 | –\$234 |
| Scheme benefits | | |
| Reduced wholesale purchase costs (\$m) | \$1,089 | \$130 |
| Avoided network investment (\$m) | \$122 | \$235 |
| Avoided cost of greenhouse gas emissions (\$m) | \$258 | \$21 |
| Avoided cost of air pollution (\$m) | \$21 | \$2 |
| Total benefits (\$m) | \$1,490 | \$388 |
| Net economic benefit (\$m) | \$1,063 | \$154 |
| Benefit–cost ratio | 3.5 | 1.7 |

The penalty rate for the ESS will remain at \$29.02 per notional megawatt hour (MWh), subject to indexation (refer to section 5 for further discussion). The penalty rate for the PDRS is set at \$2.26 per certificate, subject to indexation (refer to section 12 for further discussion).

2.2 Conditions for reviewing the schemes

The ES Act requires the Minister for Energy and Environment to review the operation of the ESS every five years to determine whether its policy objectives and legislative settings remain valid and appropriate.² The Government will set a similar requirement for the PDRS.

The next statutory review of the ESS is due to be tabled in Parliament by June 2025. The first statutory review of the PDRS will be tabled at the same time. Either scheme may also be terminated if an equivalent national scheme is established.

The ES Act sets out the conditions under which the Minister may change the ESS energy savings targets and penalty rates by regulation.³ Before changing targets or penalty rates, the Government conducts a review. The conditions include:

- harmonisation with another state-based or national scheme
- an under or over-supply of certificates
- significant changes to the ESS Rule
- significant changes to the policy or regulatory framework or the market conditions in which the ESS operates.

¹ Discounted using a discount rate of 7%

² ES Act Schedule 4A, clause 77

³ ES Act Schedule 4A, clauses 8 and 17

The Government will adopt similar conditions for reviewing the PDRS targets. In addition, the Government will review targets for both schemes if there is a forecast breach of the EST.

2.3 Safeguard compliance periods

In the Safeguard consultation paper, the Government proposed setting the compliance period for the PDRS as the financial year. This was because a financial year covers the whole summer period when most peak events occur.

The compliance year for the ESS is the calendar year. To reduce administration costs, the Government proposed changing the compliance year for the ESS to the financial year to align with the PDRS.

The policy intent of the ESS is to reduce energy consumption over the entire year, whereas the purpose of the PDRS is to reduce peak demand during the summer period when demand is highest.

In January 2021, the Government consulted further with stakeholders about the compliance period for the PDRS. Most stakeholders supported the PDRS having a compliance period that covers the summer months only.

The Government will retain the compliance year for the ESS as the calendar year. The compliance period for the PDRS will cover one summer period and be from 1 November to 31 March. This is administratively simple, as it captures an entire summer period, and aligns with the purpose of the scheme to reduce peak demand in summer.

3. Other Safeguard policy settings

3.1 Maturing technologies

The Government will continue monitoring the uptake of activities under the Safeguard schemes to understand the broader market and regulatory factors influencing change over time.

When required, the Government will modify baselines and remove incentives to ensure the Safeguard encourages energy saving and peak demand reduction activities that may not occur otherwise. The Government is committed to consulting stakeholders and providing appropriate notice before implementing significant changes to calculation methods and baselines.

3.2 Complementary programs

During consultation, the Public Interest Advocacy Centre (PIAC) suggested the Government introduce sub-targets for specific groups, such as the residential sector or low-income households.

The Government has decided to target the specific market barriers faced by low-income households by providing complementary energy efficiency programs. This delivers energy bill savings to vulnerable households more cost-effectively and is easier to administer than the other options considered. This may also apply to other sub-groups, if they face specific market barriers to implementing energy saving activities.

Under the Climate Change Fund 2017–22, the Government expanded its range of programs to ensure household and business access to the benefits of energy efficiency, including:

- support for low-income households to buy more efficient appliances (now closed)
- support for low-income households to install solar or solar-battery systems

- energy saving upgrades for social housing clients to assist the state's most vulnerable households
- discounts on equipment upgrades for households and small businesses.

The Government also supports households to reduce energy bills through rebates.

In addition, the Government regularly reviews the ESS Rule to update calculation methods and develop new energy saving activities to broaden access to the scheme. The PDRS will also include a wide range of activities, covering both households and small businesses. Depending on the future of programs to support access, future scheme reviews may consider the need for sub-targets for cohorts experiencing energy bill pressure.

Part B: Reforms to the Energy Savings Scheme

4. ESS targets

The NSW Electricity Strategy announced the Government will set a more ambitious energy savings target for the ESS. The Safeguard consultation paper sought stakeholder feedback on the rate at which the target should increase, as well as key issues the Government should consider when setting scheme targets.

Final position

The Government will increase targets from 2022, reaching 13% by 2030. The target will then remain at 13% until the end of the scheme in 2050. Table 1 sets out the new annual energy savings targets from 2022.

4.1 Stakeholder submissions

Most of the stakeholders commented on the ESS reforms in support of the Government's decision to increase the target but had mixed views on the rate at which the target should increase.

Advocacy groups and the energy services industry support a steeper ramp-up because:

- it would maximise the environmental and job creation benefits of the scheme
- the certificate surplus indicates the demand for energy efficiency activities supports a more ambitious target.

Some energy retailers, large energy users and IPART cautioned against increasing targets too quickly. EnergyAustralia and Origin Energy argued target increases should be conservative over the next few years to allow more time for the market to transition to new activities as incentives for commercial lighting reduce and the economy recovers from the impacts of the COVID-19 pandemic.

4.2 Summary of the analysis

Based on stakeholder feedback, the Government modelled three options for setting annual energy savings targets for the ESS:

Option 1: A target increasing linearly to 13% by 2030

Option 2: A target increasing faster, reaching 13% by 2027

Option 3: A higher target, reaching 15% by 2030.

Analysis for the Department indicates there are sufficient opportunities to support a higher target. These opportunities could save 10,400 gigawatt hours (GWh) of electricity and 20 petajoules (PJ) of gas each year in New South Wales.

Commercial lighting upgrades, which have accounted for the majority of energy savings delivered under the ESS to date, are approaching market maturity. New activities will need to be taken up to meet the scheme's energy savings targets.

For the purposes of cost-benefit analysis, the Department considered the lifetime costs and benefits of targets to 2030. Based on the cost-benefit analysis, a target of 13% by 2030 will deliver the greatest net economic benefit for New South Wales. The target will then remain at 13% until the end of the scheme in 2050.

5. ESS penalty rates

The scheme penalty rate was set in 2009 based on economic modelling carried out at the time. The Safeguard consultation paper sought stakeholder feedback on whether the penalty rate remains at an appropriate level.

Final position

The Government will retain the current penalty rate of \$29.02 per notional MWh in 2020. IPART will continue to adjust the rate annually to account for increases in the Consumer Price Index (CPI).

5.1 Stakeholder submissions

Around one-quarter of the stakeholder submissions commented on the scheme's penalty rate. Most of these supported the Government's intention to retain it at the current level. Two submissions recommended the penalty rate be altered with reference to updated economic modelling.

5.2 Summary of the analysis

The current penalty rate is set at an appropriate level, as:

- the penalty rate has encouraged scheme participants to meet their obligations by buying and surrendering certificates rather than paying penalties
- certificate prices have traded below the current penalty rate, indicating energy saving activities can be implemented at a lower cost
- the tax-effective penalty rate remains lower than the short-term cost of electricity supply, implying the cost of saving energy remains lower than the cost of additional supply.

6. ESS exemptions

The ESS provides partial or full exemptions for emissions-intensive, trade-exposed industries. The Safeguard consultation paper sought stakeholder feedback on whether to expand exemptions to small electricity retailers, as they may face disproportionately high administrative costs of establishing and running scheme compliance systems.

Final position

As an emergency response to the COVID-19 pandemic, the Government is providing small retailers with an exemption for the 2020 compliance year. A full exemption will apply to retailers that have fewer than 5000 customers and have liable acquisitions of less than 30,000 MWh.

The existing partial exemptions for emissions-intensive, trade-exposed industries will continue.

6.1 Stakeholder submissions

Approximately one-quarter of the stakeholder submissions commented on small retailer exemptions. Stakeholder views were divided, with half supporting exemptions for small retailers and the other half opposing them or offering alternatives to full exemptions.

6.2 Summary of the analysis

Analysis of exemptions under the ESS shows:

- new energy retailers are continuing to enter the NSW market
- exemptions for small retailers may impact market competition and scheme efficiency
- historically, small retailers have been able to meet their target obligations.

The COVID-19 pandemic had a negative impact on scheme participant compliance with their 2019 obligations, disproportionately affecting small retailers. These challenges are likely to persist into the 2020 compliance year.

7. Fuel switching

The Government considered a range of issues in relation to the expansion of eligible fuel switching activities under the ESS. This section sets out the analysis and final positions on:

- whether fuel switching should be limited to grid connected energy or also include non-grid connected energy (section 7.1)
- how the ESS can complement other schemes such as the Renewable Energy Target (RET), Emissions Reduction Fund (ERF) and NSW Building Sustainability Index (BASIX) (section 7.2)
- where fuel can be sourced from when switching fuels (section 7.3)
- how to count energy savings from fuel switching activities (section 7.4)
- circumstances under which the Government should consider extending scheme liability beyond electricity (section 7.5).

7.1 Eligible fuels

The NSW Electricity Strategy signalled the Government's intention for the Safeguard to cover a wider range of activities that reduce demand on electricity and gas networks. The Safeguard could also include switching from other fuels such as onsite, stationary use of diesel to more affordable alternatives.

Final position

The Government will expand the ESS to include fuel switching activities for both grid connected and non-grid connected energy. This includes:

- switching from grid connected non-renewable gas or electricity to bioenergy, green hydrogen, solar thermal or other alternatives
- switching from non-grid connected energy, such as onsite, stationary use of diesel to an affordable alternative.

The Government will amend the ESS Rule to remove new fuel switching activities from electricity to non-renewable gas.

7.1.1 Stakeholder submissions

Twenty-six stakeholders commented on this topic, with the majority broadly supporting expansion of the ESS to include a wider range of fuel switching activities.

Several stakeholders suggested the residential sector has significant opportunities to save energy by installing solar and heat-pump water heaters.

Six stakeholders supported expanding the scheme to include fuel switching beyond grid connected energy. Several stakeholders suggested there is a significant opportunity to reduce onsite diesel consumption in the agricultural sector by switching to other fuels.

Large energy users and the Energy Users' Association of Australia (EUAA) suggested limited fuel switching opportunities are available for large industrial and commercial businesses and sought further consultation on the introduction of these activities into the ESS.

7.1.2 Summary of the analysis

Analysis for the Department indicates there are opportunities to save 717 GWh of electricity, 15 PJ of gas and 138 megalitres (ML) of diesel each year in New South Wales through fuel switching activities.

Expanding the scheme to include more fuel switching activities would widen the opportunities and maximise consumer choice for energy efficiency solutions. Modelling by the Department indicates expanding the scheme to include more fuel switching options would increase the net economic benefit of the ESS by \$483 million by 2040.

Removing new fuel switching activities from electricity to non-renewable gas such as natural gas and liquefied petroleum gas (LPG) will help free up gas supply for industries in New South Wales that are heavily reliant on gas.

7.2 Complementing other schemes and regulations

Certain energy efficiency technologies are eligible for incentives from other schemes such as the Australian Government's Renewable Energy Target (RET) and Emissions Reduction Fund (ERF) or can be installed to comply with regulatory requirements such as the NSW Building Sustainability Index (BASIX).

As the objectives of the RET and the ESS are different, the two schemes can co-exist and reward the same technologies. Under the ERF, an emissions reduction project must not include any energy saving activity for which an incentive has been, or will be, claimed under a state-based scheme such as the ESS.

The Safeguard consultation paper sought stakeholder feedback on how the ESS can complement incentives and requirements under other schemes.

Final position

The Government will expand the ESS to provide incentives for energy saving technologies also eligible under the RET, including:

- solar and heat-pump water heaters
- solar irrigation systems
- bioenergy technologies.

The incentive will be in addition to that available from the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET), with the ESS incentive calculated using the full deeming period as specified in the ESS Rule.

To ensure complementarity with BASIX, incentives for solar and heat-pump water heaters in homes will be available where these replace existing electric or gas hot water systems.

The ESS will complement the ERF by providing an alternative pathway to encourage energy savings projects, including bioenergy projects. Projects claiming incentives through the ESS will not be eligible under the ERF.

7.2.1 Stakeholder submissions

Twenty stakeholders commented on how the ESS could complement the RET. Many of these supported expanding the ESS to include technologies being phased out under the SRES. Several stakeholders stated that without continued financial support, solar and heat-pump water heaters will not be able to compete with cheaper, less efficient electric and gas water heaters.

Stakeholders working closely with the agricultural sector strongly supported incentives for solar irrigation systems, which depending on size, are eligible under the SRES or LRET

Five stakeholders suggested the ESS should also provide incentives for rooftop solar PV, with three stakeholders arguing the technology is commercially mature and already receives sufficient incentives from other schemes.

Large energy users suggested the technologies under the SRES do not require additional incentives or that this idea required further investigation. IPART cautioned it would be difficult for the ESS to provide incentives in addition to those under the SRES in a way that ensures additionality.

7.2.2 Summary of the analysis

By adding to incentives under the RET, the ESS can encourage energy saving activities that otherwise would not take place as:

- high upfront costs remain a barrier for uptake of bioenergy technologies, solar irrigation pumps and solar and heat-pump water heaters
- declining incentives from the RET will reduce uptake of certain energy saving technologies
- uptake in New South Wales of solar and heat-pump water heaters is significantly lower than in Victoria and South Australia, where the equivalent state schemes both top up SRES incentives.

Rooftop solar PV is commercially mature and does not require further government support.

BASIX encourages the uptake of efficient water heaters in new dwellings. The ESS can complement BASIX by encouraging solar and heat-pump water heaters that replace electric and gas hot water systems in existing dwellings.

Under the ERF, an emissions reduction project must not include any energy saving activity for which an incentive has been, or will be, claimed under a state-based scheme such as the ESS. The ESS can complement the ERF by providing an alternative pathway to encourage energy savings projects.

7.3 Eligible sources of fuels

Fuels may come from different sources. Feedstock for bioenergy projects can be sourced from inside or outside an activity or site boundary. Alternatively, renewable energy can also be delivered through the electricity or gas distribution network. The Government has considered where alternative fuels can be sourced from, as this influences which activities will be eligible under the scheme.

Final position

The Government will expand the scheme to include fuel switching activities that source alternative fuels on site or off site (but not via the electricity or gas network).

All bioenergy projects must comply with regulatory requirements to protect the environment and human health.

7.3.1 Stakeholder submissions

The six stakeholders that commented on this issue had a range of views on where fuels should be sourced from for fuel switching activities.

Nature Conservation Council of NSW argued biomass derived from native forests should not be eligible. Two stakeholders suggested providing incentives for switching to biogas delivered through the gas network, while two stakeholders cautioned against this.

IPART supported fuel switching where this occurs within the same industrial process.

7.3.2 Summary of the analysis

Expanding the ESS to include activities that source fuels from on site or off site will maximise consumer choice and the available opportunity for fuel switching. Restricting eligible activities to those using waste by-products sourced within the same production process or site would exclude a wide range of opportunities to save energy, lower energy bills and reduce demand on the grid.

The ESS helps households and businesses implement energy saving activities by upgrading, changing the usage or implementing other enhancements to end-user equipment. It is not a role of the scheme to encourage supply-side measures such as injecting biogas into the network.

All bioenergy projects will need to comply with regulatory requirements in place to protect the environmental values of New South Wales.

7.4 Certificate conversion factors

The ESS uses certificate conversion factors to calculate ESCs for fuel switching activities between electricity and gas.

The certificate conversion factor for gas is based on the primary energy factor of natural gas relative to grid electricity in New South Wales.

Under the current ESS Rule, the definition of 'gas' includes biogas. This means no ESCs are generated by switching from natural gas to renewable gas. There are no certificate conversion factors for other fuels such as diesel.

Final position

The Government will retain the current electricity certificate conversion factor. Certificate conversion factors for the other fuels will be calculated based on their non-renewable primary energy factors relative to grid electricity in New South Wales. Table 3 sets out the final certificate conversion factors for each fuel.

The definition of gas will be amended in the ESS Rule to clearly define biogas as a unique fuel type.

The Government will review certificate conversion factors every five years or if the energy mix of the NSW electricity grid changes significantly.

7.4.1 Stakeholder submissions

Ten submissions commented on how energy savings should be counted for fuel switching activities. These stakeholders believed the Government should consider units of energy saved and greenhouse gas emissions avoided when counting savings from fuel switching activities.

7.4.2 Summary of the analysis

Fuel switching activities can reduce the consumption of non-renewable primary energy, delivering bill savings and improving reliability. Certificate conversion factors based on non-renewable primary energy recognise the value of saving non-renewable primary energy.

The current definition of 'gas' under the ESS includes biogas. To allow certificates to be created by switching from non-renewable to renewable gases, biogas needs to be recognised as a unique fuel type.

Table 3 Certificate conversion factors for each fuel type

| Fuel | Certificate conversion factor |
|--------------------------------|-------------------------------|
| Electricity | 1.06 |
| Natural gas and LPG | 0.47 |
| Diesel | 0.47 |
| Biogas | 0.17 |
| Biomass | 0.08 |
| Biofuels | 0.21 |
| Onsite renewables ⁴ | 0 |

⁴ Includes, but not limited to, solar PV electricity for solar irrigation and green hydrogen generated on site.

7.5 Extending scheme liability

In 2015, the Government added gas efficiency and fuel switching to the ESS. Scheme liability was retained on the electricity sector only as the potential for cross-subsidy was low.

The Safeguard consultation paper sought stakeholder views on whether and when the Government should consider extending scheme liability beyond the electricity sector.

Final position

The Government will retain scheme liability on the electricity sector only. The Government will monitor the scale of non-electricity activities and will consider extending liability beyond the electricity sector if cross-subsidy from the electricity sector to other sectors becomes material.

7.5.1 Stakeholder submissions

Around one-quarter of the stakeholder submissions commented on scheme liability. Around half of the submissions supported extending scheme liability beyond the electricity sector. Some stakeholders stated extending liability should be considered if cross-subsidy from electricity to gas customers occurs at a material level.

7.5.2 Summary of the analysis

Analysis of scheme liability shows:

- most energy users in New South Wales use electricity for most of their primary energy needs
- reduced consumption of electricity will continue delivering the majority of savings under the ESS.

Part C: Design of the Peak Demand Reduction Scheme

8. Scheme objectives

The NSW Electricity Strategy outlined the NSW Government's plan to introduce a certificate scheme to encourage dependable peak demand reduction, as part of the Energy Security Safeguard.

The object of the Safeguard is to improve the affordability, reliability and sustainability of energy through the creation of financial incentives encouraging 'energy activities', in this case peak demand reduction. While the Peak Demand Reduction Scheme (PDRS) will contribute to all three Safeguard objectives, its main focus is to improve reliability.

Final position

The Government will set the principal objective of the PDRS as the creation of financial incentives to reduce the peak demand for energy by encouraging peak demand reduction activities.

Sub-objectives will reflect the three Safeguard objectives, with the main focus on improving reliability:

- main sub-objective: improve reliability by reducing NSW peak demand
- other sub-objectives:
 - improve affordability by placing downward pressure on NSW wholesale electricity prices
 - improve sustainability by increasing load flexibility.

8.1 Summary of the analysis

Because a shortfall in firm capacity is most likely to occur at times of peak demand, peak demand reduction plays a critical role in improving reliability. The scheme will focus on this objective.

9. Complementing national mechanisms

The Government consulted on the best ways for the PDRS to complement national mechanisms. The scheme can both complement existing mechanisms and prepare the NSW market for the demand side initiatives under the national post-2025 market design reforms.

Final position

The PDRS will complement national mechanisms by:

- paying for the ability to reduce peak demand ('capacity') while allowing other mechanisms to make operational payments
- not duplicating mandatory legal requirements nor national dispatch mechanisms operated by the Australian Energy Market Operator (AEMO)
- including small customers by providing incentives for a broader range of peak demand reduction activities
- considering the post-2025 market design in statutory reviews of the scheme.

9.1 Stakeholder submissions

Sixteen stakeholders commented on the ways the scheme could complement national mechanisms, including 11 that supported the scheme. Three stakeholders did not support a state-based scheme. Suggestions from stakeholders included focusing on the residential sector, sufficiently incentivising peak demand reduction activities, allowing participants to access revenue streams from different schemes, and being adaptable to proposed changes in the national regulatory framework.

9.2 Summary of the analysis

The PDRS can complement national mechanisms by:

- providing dependable payments based on available capacity, which add to irregular dispatch payments in response to peak events
- offering incentives to all energy users from large to small and for a broader set of eligible activities.

Scheme reviews will consider post-2025 market design.

10. Scheme commencement

The Government intends to introduce the PDRS, or some of its elements, as soon as possible. The consultation paper invited stakeholder feedback on:

- a reasonable start date for the scheme
- elements of the scheme that can be brought forward, such as the early creation of certificates ahead of surrendering requirements
- support needed by industry to prepare for the introduction of the scheme.

Final position

Scheme liability and certificate creation will commence on 1 November 2022 for the 2022–23 compliance period. Accreditation of service providers can commence following gazettal of the scheme rule in the middle of 2022.

The Government will collaborate with industry on the detailed scheme design and provide a range of supports for industry, including:

- training and information sessions on the scheme
- pilots and trials of scheme elements, including measurement and verification of peak demand reduction from certain technologies
- promotion of the scheme to energy users
- financial and technical support for energy users to reduce costs of participation.

The Government will shortlist methods from the ESS Rule that can be adapted into methods for calculating peak demand savings under the PDRS. These will form the first version of the PDRS Rule and operate in parallel with the ESS Rule. Activities using these methods and implemented from the commencement date of the PDRS Rule may create certificates once the PDRS commences in 2022.

For other activities, prospective certificate providers will be able to submit a registration of intent. Subject to assessment, these projects will be eligible to generate peak reduction certificates (PRCs) once certificate creation commences.

10.1 Stakeholder submissions

Twenty-two stakeholders commented on a preferred commencement date for the PDRS. Advocacy groups and the energy service industry supported an early commencement date.

Others, including electricity retailers, Ausgrid and some large energy users highlighted the need for further consultation and sought more information about the scheme. IPART pointed out it will need time to ensure the necessary framework and systems, including IT systems, are in place before scheme commencement.

Four stakeholders suggested elements of the scheme that could be brought forward, including eligibility for the scheme and early creation of certificates.

Eleven stakeholders commented on industry support needed to prepare for the scheme's introduction. Key themes were collaboration and information sharing before scheme commencement, training and information sessions, promotion of the scheme, pilots and trials, and financial and technical support to reduce participation costs.

10.2 Summary of the analysis

The PDRS can support economic recovery following the COVID-19 pandemic, as projects supported under the scheme can generate economic activity and jobs. Households and businesses implementing projects under the scheme will also benefit from lower electricity bills.

Advocacy groups and the energy service industry supported the scheme commencing soon. Most stakeholders highlighted the need for detailed design, including:

- consultation on calculation methods and technical guidance
- interaction with national programs such as the WDRM and five-minute settlement under the National Electricity Market (NEM)
- frameworks to support scheme administration and regulation.

Some retailers and industry representatives advocated certificate creation commencing ahead of scheme liability, highlighting the need to ensure a sufficient supply of certificates to meet liability.

Stakeholders made a range of suggestions on support industry needs to prepare for the scheme, including:

- training and information
- promotion of the scheme to ensure participation of vulnerable and disadvantaged households
- pilots and trials to support certificate providers
- fast-tracking of demand saving activities also eligible under the ESS.

11. Peak reduction certificates

Certificates for the PDRS will provide a common unit of measurement for both scheme targets and activities, like energy savings certificates (ESCs) for the ESS.

Final position

The certificate will reflect the scheme's main focus on reliability.

A PRC will represent 0.1 kilowatt of peak demand reduction capacity averaged over one hour.

To create certificates, activities will have to be available to reduce peak demand during a defined peak period. Certificates will be identified with the compliance period in which the capacity is available.

Accredited certificate providers will create certificates from activities using calculations considering capacity, duration and the likelihood that the capacity is available when needed ('firmness'). Certificate creation will require evidence that capacity is available during the defined peak period.

To allow for compliance period identification, evidence requirements and validity limits, certificates will have a status of one of: dormant, pending, active, surrendered or expired.

11.1 Stakeholder submissions

Sixteen stakeholders commented on how the scheme's certificates could best capture capacity, timing, duration and the availability factor. Two stakeholders suggested certificate design should be linked to scheme objectives.

Eleven stakeholders commented on who would be best placed to manage the financial risk that capacity is not available when needed. Suggestions on who should manage the risk included the market, government, certificate providers and aggregators.

Several stakeholders recommended the PRCs be based on peak demand reduction performance, rather than estimated capacity.

11.2 Summary of the analysis

The PRC should reflect the scheme's main objective by measuring peak demand reduction capacity at peak periods.

To provide certainty for certificate providers and energy users, the scheme will specify a fixed peak period when peak demand reduction capacity must be available. Because peak demand is time specific, certificates should reflect that capacity needs to be available in a specific compliance period.

Several stakeholders noted the risk of peak demand reduction capacity not being available during peak events. The framework for calculating certificates needs to account for the likelihood that capacity is available. Evidence requirements will need to balance the risk of capacity not being available and the cost of measurement and verification.

12. Setting the scheme target and penalty rates

The PDRS targets are the amount of peak demand reduction capacity the scheme aims to make available each compliance period. Targets need to balance the opportunity for peak demand reduction with the cost of implementation and deliver the greatest net economic benefit for the NSW economy.

The penalty rate helps ensure compliance by creating an incentive for liable parties to purchase and surrender certificates. It also acts as a 'safety valve', capping scheme costs at an economically efficient level.

Final position

The peak demand reduction target for the PDRS will commence at 0.5% for the 2022–23 compliance period, gradually increasing to 10% by 2029–30. The target will then remain at 10% until the end of the scheme in 2050. Exemptions will be considered when calculating individual targets for scheme participants.

The peak period during which activities will be required to be available is from 2.30pm to 8.30pm Australian Eastern Standard Time (AEST) during the compliance period of 1 November to 31 March.⁵

The penalty rate for the PDRS will be set at \$2.26 per certificate, subject to indexation.

The Government will review PDRS targets, penalty rates and the peak period for activities when certain conditions are met, in a similar way to the ESS. In addition, the Government will review targets if there is a forecast breach of the EST.

12.1 Stakeholder submissions

Eight submissions commented on the size of the peak demand reduction opportunity available in New South Wales. The Energy Savings Industry Association (ESIA) suggested a target of 3000 MW reduction by 2030, while the Energy Efficiency Council (EEC) suggested demand response could add at least 20% capacity to the electricity system. Other stakeholders identified specific opportunities for peak demand reduction.

The consultation also invited stakeholder feedback on penalty rates, but most stakeholders focused on targets and other aspects of scheme liability.

12.2 Summary of the analysis

Stakeholder submissions and analysis commissioned by the Department show New South Wales has significant opportunities to reduce peak demand. These include opportunities across peak demand saving, response and shifting for residential, commercial and industrial electricity customers.

The Department conducted a cost–benefit analysis on three options to set scheme targets. For the purposes of cost–benefit analysis, the lifetime costs and benefits of targets to 2029–30 were considered. Based on the Department's analysis, a target of 10% by 2029–30 will deliver the greatest net economic benefit. The target will then continue at 10% until the end of the scheme.

⁵ The NEM is operated on AEST (it does not adjust for daylight saving).

At a certificate price above \$3.22, the benefit–cost ratio of the scheme falls below 1.1. After accounting for the tax treatment of penalties, this equals a penalty of \$2.26. Modelling for the Department indicates certificates will be created by activities at a significantly lower cost than \$3.22.

13. Establishing liability for the scheme

The PDRS will require liable parties to surrender certificates to meet target obligations. This section discusses who liable parties are and how liability is determined.

Final position

The PDRS will have the same liable parties as the ESS to cover all electricity used in New South Wales. These are:

- all electricity retailers
- generators supplying directly to customers in New South Wales
- large energy users that purchase electricity directly from the NEM.

The PDRS will align with the ESS by extending exemptions for certain emissions-intensive and trade-exposed energy users and to some or all small retailers while they are affected by emergencies such as COVID-19.

The certificate target for the scheme as a whole will be calculated from the scheme percentage target, forecast peak demand and the length of the peak period.

Individual certificate targets for each scheme participant will be calculated from the scheme certificate target, the contribution of the scheme participant to actual peak demand on high demand days and any exempt load supplied by the participant during the same period.

13.1 Stakeholder submissions

Eighteen stakeholders commented on liable parties, exemptions, allocation of targets and liabilities. Most stakeholders supported adopting the same liable parties for the PDRS as for the ESS, with some stakeholders arguing against exemptions. The proposed approaches to determining allocation of targets and individual targets were also largely supported.

13.2 Summary of the analysis

As the PDRS benefits the electricity sector, liable parties should cover all electricity used in New South Wales. The ESS liable parties already do this. Using the same liable parties for the PDRS is administratively simple and gives retailers and large energy users a direct incentive to reduce their liability by reducing their peak demand. Exemptions will also be aligned to the ESS.

Determining individual peak demand reduction targets for each liable party is more complex than for the ESS. The scheme regulator will need to calculate a scheme certificate target from the percentage reduction target and the length of the peak period.

Liable parties will then calculate their individual targets from their contribution to actual peak demand and any exempt loads.

14. Ensuring flexibility

Flexibility arrangements under the scheme refers to certificate carry-forward and expiry provisions. Carry-forward provisions allow liable parties to carry forward a certain portion of their liability to the next compliance period. Expiry provisions could allow certificates to be valid for one or more years.

Final position

Liable parties may carry forward a portion of their liability to the next compliance period. The maximum carry-forward amount will be 20% in the first compliance period and 10% in subsequent periods.

Certificates will be valid for three years, beginning in the compliance period in which the peak demand reduction capacity is available. After three years, the certificate will expire.

14.1 Stakeholder submissions

All 10 stakeholders that commented on carry-forward arrangements for target shortfalls supported the carry forward of liabilities in some form.

Sixteen stakeholders commented on certificate expiry, of which 13 supported certificates being transferrable to future compliance periods.

14.2 Summary of the analysis

The key goal of flexibility is to smooth short-term mismatch between certificate demand and certificate supply, without compromising scheme objectives.

All stakeholders supported the introduction of carry-forward provisions in some form. Most stakeholders supported certificates being used in future compliance periods.

Carry-forward provisions will help avoid price shocks, while imposing a time limit on certificate validity will support creation of dependable peak demand reduction capacity.

15. Peak demand reduction activities

Many activities provide capacity to reduce demand at peak times, and competition among these will deliver the most efficient outcome. Like the ESS, the PDRS will provide a range of methods for calculating peak demand reduction capacity.

As the scheme will create a market for new and emerging products and services, existing consumer protection frameworks may need to be reviewed to ensure consumer rights are protected.

The Government consulted on whether to recognise that the value of peak demand reduction differs by location, such as by using location-based multipliers or activities that are specific to certain locations.

Final position

The PDRS will encourage efficient peak demand reduction activities by enabling competition among peak demand saving, peak demand response and peak demand shifting.

The Government will adopt a collaborative approach to developing calculation methods. As part of this, industry may submit calculation methods to the Department for review. The Department will release guidelines on method development in the second half of 2021.

The Government will harmonise consumer protections under the PDRS with the AEMC's principles where possible. As many of these issues are specific to individual peak demand reduction activities, the Government will consult with industry on how best to ensure consumer protection when developing the scheme rules and calculation methods.

The PDRS will build on the accreditation requirements of the ESS. The Government will provide training and information sessions on the PDRS to interested parties.

The Government will encourage location-based demand reduction by:

- adding a network loss factor to calculation methods to recognise the value of avoided network losses and encourage activities in regional areas
- publishing aggregated activity data at the local network level
- evaluating the impact of peak demand reduction activities on local reliability and local network constraints.

15.1 Eligible activities

15.1.1 Stakeholder submissions

Nineteen stakeholders commented on eligible activities under the scheme. Most provided suggestions and comments on the types of activities they would like included with some stakeholders providing specific examples.

Ten stakeholders commented on which calculation methods should be prioritised. Suggestions ranged from prioritising methods providing the largest reductions in peak demand to incentivising demand reductions by households and small to medium businesses.

15.1.2 Summary of the analysis

Most stakeholders supported the three proposed peak demand reduction activities and identified a broad range of calculation methods that could be prioritised for development.

IPART argued the PDRS should not incentivise peak demand savings rewarded under the ESS. The ESS values all energy savings equally and does not recognise the full value of energy savings at peak times. The PDRS can recognise the additional peak benefit of these technologies, above and beyond the year-round energy savings rewarded by the ESS.

15.2 Consumer protections

15.2.1 Stakeholder submissions

Eleven stakeholders commented on consumer protection considerations under the scheme. A key theme in the submissions was the need for a principles-based consumer protection framework to provide sufficient flexibility to allow for adaptation to changes in technologies and markets.

15.2.2 Summary of the analysis

Most stakeholders agreed with the proposed consumer protection framework and highlighted issues that should be considered. Many of these are specific to individual peak demand reduction activities and are best addressed in the scheme rules and calculation methods.

15.3 Qualification requirements for certificate providers

15.3.1 Stakeholder submissions

Eight stakeholders commented on the qualifications certificate providers should be required to have. Six of these specified their support for qualifications to align with ESS requirements. Suggestions from the remaining stakeholders include training and accreditation in peak demand reduction (Endeavour Energy), alignment of qualifications with installation requirements (AGL), and the importance of experience combined with qualifications (Energy Conservation).

15.3.2 Summary of the analysis

Stakeholders supported the PDRS building on the accreditation requirements of the ESS and provided suggestions for certificate provider capacity development.

15.4 Location-based activities

15.4.1 Stakeholder submissions

Eighteen stakeholders commented on the issue of location-based activities. Thirteen stakeholders broadly supported location-based savings, with several of these highlighting the need to validate outcomes or suggesting introduction at a later stage. Four stakeholders were opposed to location-based activities at this stage. IPART did not express a preference but noted that some link to the location of activities is a common feature of similar schemes.

15.4.2 Summary of the analysis

Activities under the PDRS should support its objectives. The scheme is focused on overall system reliability. Location-based demand reduction can improve reliability at the local level and reduce local network costs.

Stakeholders supported using location-based multipliers, like the regional network factor in the ESS. Another option to encourage location-based demand reduction activities is for the Government to provide location-based information about activities implemented under the scheme.

Part D: Energy Security Safeguard administration

The Government will align administration and compliance between the ESS and the PDRS where possible. This will include accreditation requirements, certificate registry and assessment of compliance of scheme participants, with modifications specific to the PDRS where these are necessary.

IPART will be the administrator and regulator of both the existing ESS and the new PDRS.

The consultation paper outlined the Government's vision for excellence in administration and operation of the Safeguard and sought stakeholder feedback on how to move closer to best practice.

The Department engaged the consultancy firm KPMG to review the administration and compliance of the ESS. The review looked at what constituted best practice administration and operation, the current operation of the ESS and made recommendations on how to achieve best practice.

Since this review was completed the Department and IPART have been working together to identify improvements to the way the Safeguard is administered. This includes looking at the supporting systems, processes and frameworks for both the Department and IPART. IPART has already begun work on implementing some of the changes outlined in this paper.

16. Formalising roles and responsibilities

The Department is responsible for designing and developing the policy framework and legislation for the Safeguard.

IPART is the administrator and regulator of the ESS and the PDRS. Its current functions are set out under the ES Act. The Act also allows the Minister to assign additional functions via a formal appointment.

Various stakeholders have expressed confusion about the roles and responsibilities of the Department and IPART.

Final position

The Minister will formally appoint IPART as the administrator and regulator of the ESS and the PDRS. The appointment will clarify IPART's roles and responsibilities and add new functions.

16.1 Stakeholder submissions

Five stakeholders provided responses to the question on what was working well with the administration and regulation of the ESS.

PIAC considered the current administrator to be satisfactory, the EEC recognised the Department's efforts in improving the operations of the ESS. ESIA recommended that a new administrator be established. Ausgrid called for greater efforts to understand customer experience. IPART identified the administrative and compliance features necessary to support the integrity of schemes under the Safeguard.

16.2 Summary of the analysis

Stakeholders sought improvement to the administration of the ESS and drew attention to approaches used by administrators of other similar schemes.

By formally appointing IPART as administrator and regulator of the ESS and PDRS, the Minister can confirm IPART's functions and clarify the Government's expectations.

17. Measuring and monitoring performance

The Government is committed to effective performance monitoring by its regulatory agencies and ensuring a customer-centric focus for its services.

Final position

The appointment of IPART will include a requirement to develop key performance indicators (KPIs) that measure the efficient and effective administration of the Safeguard to support the achievement of scheme outcomes. The KPIs will need to be approved by the Department, and IPART will be required to report against these KPIs to the Minister on an annual basis.

IPART will also be required to review and update the KPIs on a regular basis to ensure they remain relevant and appropriate.

17.1 Stakeholder submissions

Four stakeholders commented on KPIs and service standards. Stakeholders suggested both KPIs that were focused on outcomes such as the promotion of scheme goals and KPIs that were focused on processes such as query response times. IPART recommended that KPIs and service standards be identified after scheme details are clearer to avoid any unintended consequences.

17.2 Summary of the analysis

The adoption of outcomes-based KPIs will be an iterative and ongoing journey that IPART has already commenced. Stakeholders supported both the adoption of outcomes-based KPIs and continued reporting against process-based indicators.

IPART will be responsible for developing and reporting against KPIs, which will include measures related to the Government's vision of being customer-centric.

18. Improving communication and engagement with stakeholders

Stakeholder submissions emphasised a need for improved communication and stakeholder engagement by IPART.

Best practice administration underlines the need to take a customer-centric approach to communication and engagement with participants. This is a key policy priority for the Government.

Through the process of developing and implementing complementary stakeholder engagement plans for the Safeguard, IPART and the Department can improve how they engage and communicate with stakeholders.

Final position

The Department will work with IPART on the development and implementation of complementary stakeholder engagement plans for the Safeguard. The plans will include a joint register of Safeguard activities and events.

18.1 Stakeholder submissions

Four stakeholders commented on stakeholder engagement.

ESIA recommended that a customer service culture be established by the administrator. AGL welcomed the Government's focus on putting the customer at the centre of everything it does. Ausgrid called for greater engagement with end-user customers, not just scheme participants. IPART noted care needs to be taken with the concept of 'customer-centric' when referring to a regulatory scheme.

18.2 Summary of the analysis

Stakeholder feedback on improving communication and engagement with stakeholders was concerned with:

- communication and engagement within a regulatory framework
- adopting a customer-centric approach and engaging with end-user customers.

19. Capability development

The success of the Safeguard relies on the ability of ACPs and other service providers to confidently engage with the rules and undertake effective energy saving activities.

To facilitate this, the Department and IPART need to work together to promote and provide capability development activities to service providers and other stakeholders.

Final position

The Government recognises that the primary responsibility for ensuring effective participation in the schemes lies with industry, i.e. with the ACPs and Scheme Participants. The Government also acknowledges that both the Department and IPART should be actively supporting the capability development of key stakeholders to ensure scheme outcomes are met.

The Department will be responsible for broader scheme promotion and working with industry groups and ACPs to support service providers and installers to build capabilities to deliver activities under the schemes. IPART will be responsible for initiatives that support ACPs, Scheme Participants, Measurement and Verification Professionals and auditors to improve their understanding and build their capability to comply with scheme requirements.

Consistent with the focus on scheme outcomes, the Department and IPART will increase coordination and collaboration on capability development initiatives, in consultation with stakeholders.

19.1 Stakeholder submissions

Stakeholder submissions supported the Department being responsible for developing the capability of service providers to deliver effective activities. IPART noted it has a role in developing guidance materials and processes to ensure compliance and that broader capacity building is the role of the Department. Both IPART and EEC suggested industry associations can play a role in developing capabilities.

Stakeholders recommended a range of activities, including workshops and training, to develop the capabilities of service providers.

19.2 Summary of the analysis

Capability development encompasses a broad range of activities beyond formal training.

Responsibility for supporting capability development under the schemes is shared between the Department and IPART. This responsibility will be clearly delineated between the two agencies to provide clarity to stakeholders.

IPART and the Department will increase coordination and collaboration on capability development initiatives to more effectively and efficiently utilise resources to address identified stakeholder needs. Industry groups will be consulted on these initiatives.

20. Compliance and enforcement

The Government's aim is to ensure compliance and enforcement action for the Safeguard is proportionate and effective. To achieve this, the Government considered a range of options, including additional powers for IPART.

IPART has responsibility for setting and implementing appropriate compliance processes and procedures based on the legislative framework. The expansion of the ESS and introduction of the PDRS will make it necessary to update the risk and compliance framework, including processes for reporting of suspected non-compliance or fraud by stakeholders and processes for complaints and appeals. IPART has already commenced this work.

Final position

The Government will:

- amend the legislation to enhance the powers of the administrator and regulator to improve its ability to prevent, detect and respond to fraud and non-compliance
- amend the legislation to clarify and streamline administration by:
 - updating the administrative review sections
 - allowing for the introduction of a binding schedule of fees for audits, should this be deemed necessary in the future
 - introducing a rolling certificate registration period
 - allowing an additional three months for preparation of the annual compliance report
 - clarifying the accreditation variation provisions.

20.1 Stakeholder submissions

Six stakeholders provided feedback on the compliance and enforcement framework. Energy service industry stakeholders supported proportionate enforcement action, asserting the need for measured efforts to enhance compliance, and the need to balance any reforms or additional powers with the functioning of the scheme. One energy service industry stakeholder recommended the audit regime be streamlined.

IPART supported the compliance and enforcement options presented in the consultation paper and requested the power to issue binding guidance material to address loopholes and clarify requirements in the rules as they are identified.

20.2 Summary of the analysis

Prevention, detection and response are key pillars underpinning a robust fraud control framework.⁶ Positive compliance outcomes will be achieved where the greatest effort is focused on prevention, and decision-making is transparent.

Stakeholders have sought more consistency in the interpretation of the ESS Rule. IPART sought the ability to issue binding guidance on the interpretation of selected sections of the ESS Rule and relevant evidence requirements, to address loopholes and clarify the requirements.

Stakeholders indicated that the high cost of, and focus on, compliance is creating a barrier for some participants and is holding the scheme back. They asked for administrative decisions and their rationale to be published, and for appeals processes to be simpler.

The extension and expansion of the ESS and creation of the PDRS provides opportunity to consider stakeholder feedback and revise the compliance framework to improve compliance outcomes.

The Government is responsible for ensuring IPART has the appropriate compliance toolkit to detect prevent, detect and respond to compliance matters. IPART is responsible for reviewing, updating and implementing the compliance framework for the Safeguard.

21. Embracing a digital future

The ESS and PDRS schemes operate in an increasingly digital environment. It is the ambition of the Government to better utilise digital technologies to achieve scheme objectives; for example, supporting the rules with fit for purpose digital platforms designed to meet stakeholder needs.

Rules are the legislative instruments underpinning the ESS and PDRS. They need to be accurate, easy to understand, use and update.

Reviews of the Safeguard rules need to strike an effective balance between certainty for service providers and maintaining flexibility to address issues as they arise. The current review process for the ESS Rule⁷ consists of a cycle of annual changes and major reviews every three years. Improvements to this process would better meet the needs of the expanded Safeguard.

⁶ KPMG 2014, [Fraud risk management: Developing a strategy for prevention, detection, and response \(PDF 1.9MB\)](#)

⁷ [Energy Savings Scheme Rule of 2009](#)

Final position

The Government encourages the uptake of new digital technologies by its agencies to realise benefits such as improved user experience, better data availability and increased delivery capabilities.

The Department and IPART will continue to explore how to better utilise digital technologies to improve service delivery and streamline operations for all stakeholders. This is consistent with Government initiatives to improve outcomes through digitalisation. IPART is exploring a possible new digital platform for the Safeguard Registry and the Department is exploring writing the Safeguard rules as code for use in digital systems.

The current rule review process will be improved to make it more dynamic for the Safeguard. This reflects the changing needs for digital delivery of the schemes and for interoperability between the ESS and PDRS rules. The Department will investigate issues-based rule changes with increased levels of stakeholder engagement, raising major issues well in advance. Future rules may also refer more to external publications, to make use of external expertise and reduce the need for rule updates.

21.1 Stakeholder submissions

Stakeholders supported the current rule review and three-year major rule review processes, while encouraging a more transparent and collaborative approach to the reviews.

One electricity retailer suggested developing 'rules as code' to streamline rule updates and their integration into service provider business systems. The same retailer also called for annual reviews of the PDRS for the first three years to ensure the rules were appropriate and effective.

21.2 Summary of the analysis

Stakeholder outcomes under the ESS and PDRS schemes are expected to be improved by the update of digital systems and processes. For example, the creation of a single digital platform to replace the ESS Portal and ESS Registry is expected to create efficiencies for stakeholders by making available 'clean', consolidated data.

Another area of interest is the digitalisation of scheme rules with benefits including increased consistency in interpretation, automation of manual processes, ability to test and model scenarios, integration with service provider software and long-term opportunities to harmonise the Safeguard with similar schemes in other states and the Commonwealth.

While there was stakeholder support for the current review process, opportunities for improvement have been identified. The Department will increase stakeholder consultation activities for rule updates and allow for references to external publications to reduce the need for rule updates. In addition, there will be annual reviews of the PDRS rule for the first three years after implementation.