

Our reference: 20/97-2, D20/14319

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22 June 2020

Mr James Hay  
Deputy Secretary  
Energy, Climate Change and Sustainability

Cc: Ms Chris Hickey  
NSW Department of Planning, Industry and  
Environment  
[energysecurity@environment.nsw.gov.au](mailto:energysecurity@environment.nsw.gov.au)

Dear Mr Hay

## ENERGY SECURITY TARGET AND SAFEGUARD - CONSULTATION PAPER - SUBMISSION FROM IPART

I am writing to provide IPART's submission on the above consultation paper. As the Scheme Administrator and Scheme Regulator of the current Energy Savings Scheme, IPART is well placed to provide insights into the proposed Energy Security Target and Safeguard framework.

I note that the Energy Security Safeguard will include two certificate schemes – an energy efficiency scheme (an expansion and extension of the Energy Savings Scheme) and a peak demand reduction scheme – and that these schemes are likely to be administered and regulated by IPART. Given this, IPART has a keen interest in helping to develop a scheme that is practical to administer, has a strong compliance framework, and delivers on the scheme's objectives.

Attached to this letter is a table outlining IPART's responses to various questions posed in the consultation paper (**Attachment A**). **Attachment B** provides the economic context on which we have based our comments. **Attachment C** provides further comments on compliance related questions.

There are a number of overarching considerations that should underpin the design of the Energy Security Target and Energy Security Safeguard:

### Complementarity with national policies

It is important that any NSW schemes work with, not against, policies and actions being undertaken at the national level. We encourage government to work closely with national bodies to ensure consistency with the national approach. This is particularly important when considering the management of peak demand and the setting of an energy security target. As you are no doubt aware, there are a number of bodies with responsibility for analysing and

ensuring energy security in the National Energy Market. The design of the NSW Energy Security Target should therefore look to enhance or complement the actions of these bodies by addressing market failures not already being adequately managed through these mechanisms. If this does not occur, NSW energy consumers could be required to fund duplicative mechanisms unnecessarily.

The design of the Energy Security Target and Safeguard should allow for accommodation of changes at a national level. This could, for example, include the 'rolling up' of the state scheme into any similar national scheme. A similar mechanism existed in the design of the Greenhouse Gas Reduction Scheme.

### **Design of the Energy Security Target**

We note that the Australian energy market already provides some price signals that encourage additional capacity and new entrants into the market or for customer load to be curtailed or shifted. Future investment in new generation, demand-response and storage is likely to reflect changes in technology, cost structures and timing. In particular, lead times for the construction of new generation, especially large-scale solar, will be shorter. This should be considered in designing the Energy Security Target, including when corrective actions are necessary. We note that AEMO's Reliability and Emergency Reserve Trader function provides for both short and long notice procurement of any shortfalls, where long notice reserve is tendered out 10 weeks or more off the projected shortfall.

A careful scheme design is required to ensure that any additional interventions into the national energy market do not negatively impact investor confidence and to make sure that the scheme incentivises the lowest cost solutions to shortfalls. We recommend drawing on industry experts to assist in the design process.

### **Additionality**

As the Energy Security Target and Safeguard will be funded through electricity prices, it should deliver a net benefit and value for money to NSW consumers. It is, therefore, important to ensure that it is incentivising activities that would not have happened if it were not for the subsidy.

While measures are in place to minimise this risk for the Energy Savings Scheme, the design of the expanded Energy Savings Scheme and introduction of the peak demand reduction scheme should include a requirement for additionality.

As the schemes evolve, the rules may require adjustment to ensure additionality is maintained. For example, the market for energy efficient lighting is now delivering energy savings that exceed the costs to upgrade and use of the lights. The market in this case no longer needs incentivising through the scheme. It will be important that sufficient flexibility is built into the design of the schemes to address additionality as an ongoing issue.

Additionality of actions may be even more difficult to isolate with the proposed peak demand reduction scheme as it will also need to accurately target activities that reduce demand in peak periods, and peak demand periods may also change over time.

## **Tradability of certificates**

We note that, within the Energy Savings Scheme, certificates are mutually interchangeable because the energy savings will be the same regardless of location and time. This will also be the case for the proposed expanded Energy Savings Scheme.

However, due to the complexities involved in capturing capacity, timing, duration, location and availability, it will be challenging to assign one value to a peak demand reduction certificate. The value of a peak demand reduction certificate is likely to vary with location and the resource mix dispatched during times of peak demand.

## **Governance and transparency**

Appropriate governance arrangements will be critical to the success and integrity of the schemes. We support having rules in place that are both clear and enforceable and that facilitate transparent and reasonable decision making. This transparency should extend to the mechanisms for writing, reviewing and amending the legislative framework for the schemes. We caution against ad-hoc amendments to the legislative framework or rules for the schemes (unless strictly necessary) as it can undermine market confidence and stability.

Having a robust regulatory framework is critical to the success of the schemes and will provide greater confidence for both investors and liable entities in the schemes. It is important to ensure that energy savings and peak demand savings are real and verifiable. Where this is not the case, the regulator needs appropriate powers to ensure scheme integrity.

Clear definition of the roles, responsibilities and accountabilities for the schemes will aid in achieving transparency and sound governance.

## **Information provision and minimising red tape**

The information provision requirements for the new Energy Security Target should be based as closely as possible on information already gathered by national bodies such as AEMO, so as to reduce unnecessary administrative burden on liable entities.

In designing the peak demand reduction scheme, we recommend consideration be given to, as much as possible, building the scheme on a similar framework to the existing Energy Savings Scheme. This would reduce the administrative burden on both participants and the Scheme Administrator, streamline access to both schemes, and be consistent with NSW Government priorities around making it easier to do business.

## **Review and Termination**

We recommend the Energy Security Target and Safeguard include review and termination provisions. It is best practice for schemes of this nature to include sunset clauses for a number of reasons, including:

- ▼ The potential for further developments at a national level (refer Complementarity section above), especially in light of the current work being undertaken by the Australian Energy Market Commission and the Energy Security Board on the market design of the National Electricity Market, and

- ▼ At some point, the market may no longer need the incentive provided under state-based schemes, at which point the schemes should be terminated or substantially modified as they would no longer be meeting the additionality test discussed above.

IPART's contact officers for this submission are Helen Day/Kristin Morris (job-share), Director, Regulation and Compliance, contactable on (02) 92908452.

Yours sincerely

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Paul Paterson

Chair

Signed by: Paul Paterson

## IPART's response to consultation questions

Implementation timeframes for the Safeguard (pages 12-13)	
<p><b>9.</b> What would be a reasonable commencement date for the new energy saving and peak demand reduction targets? Please provide an explanation for your response.</p>	<p>As proposed administrator and regulator of the new schemes, IPART would like to work further with the Department to determine a practical commencement date. A key consideration is the need to develop an effective IT system to support implementation of the new schemes.</p> <p>We would also suggest consideration be given to the compliance, certificate creation and reporting deadlines for the schemes. The current Energy Savings Scheme (<b>ESS</b>) has deadlines in April and June of each calendar year, which place significant resource demands on scheme participants, Accredited Certificate Providers, and the Administrator. The impact of placing additional administrative demands on stakeholders (including those related to resourcing and cash flow) at these times via the peak demand reduction scheme should therefore be considered.</p> <p>There may be value in the Department inviting stakeholders to participate in a co-design group, which could take these practical considerations into account. We would also be happy to provide insights from a Scheme Administrator's perspective into such a group.</p>
<p><b>10.</b> Could elements of either scheme, such as the early accreditation of certificates ahead of surrendering requirements, be brought forward? Please provide an explanation for your response.</p>	<p>IPART supports the implementation of the proposed Energy Security Safeguard in a timely and efficient manner. Before any elements of the scheme can be commenced, it is important to have the necessary frameworks in place to support their administration and regulation. This includes the following:</p>

	<ul style="list-style-type: none"> <li>▼ clear administrative arrangements in place for the scheme administrator and regulator</li> <li>▼ rules to support the different elements of the scheme such as accreditation of certificate providers</li> <li>▼ a compliance framework to ensure appropriate accreditation of certificates</li> <li>▼ an integrated IT system (combining and updating the ESS Registry and ESS Portal) to accommodate existing and new certificates created under the different schemes</li> </ul> <p>In addition, all participants would also need to have clear understanding of the rules to ensure compliance. Certainty around the rules will be critical to a smooth start to the schemes.</p> <p>We anticipate that trading of certificates could occur at any time after the commencement of the scheme, depending on the appetite of the market.</p> <p>IPART would welcome the opportunity to work with the Department in considering these further.</p>
<b>The NSW Government will extend the ESS to 2050 and increase targets (pages 16–17)</b>	
<b>12.</b> What issues should the NSW Government consider when setting targets to 2030? At what rate should the targets be increased to reach 13% by 2030?	<p>IPART's view is that, to encourage participation in the scheme, targets should be set in a manner that provides investor certainty. This would be best delivered by a steady, predictable increase in targets which is notified to the market well in advance. We note that the current rate of target increase has been designed with a view to the market's ability to mobilise energy saving investments in time.</p> <p>There is a risk that if the timetable for target increases is set at a level that is too ambitious, certificate prices could potentially rise above the penalty rate undermining the scheme. Further analysis of this issue is in <b>Attachment B</b>.</p>

<p><b>14.</b> What would prevent the uptake of new opportunities? What support (including new standards and calculation methods) does industry need to transition to new opportunities?</p>	<p>There are potential technical, economic and capacity barriers to the uptake of new technologies under an expanded ESS. IPART would like to work further with the Department on developing the expanded scheme to ensure these barriers can be addressed.</p> <p><b>Technical</b> IPART concurs with the view of the Department that emergent technologies often do not have common technical standards that would facilitate industry wide implementation. We note that to date, the technical complexity of certain calculation methods has been a barrier to the take up of emergent technologies. Opportunities for simplified or streamlined calculation methods should be considered to address this barrier.</p> <p><b>Economic</b> For some more complex activities, the cost to implement the activities may outweigh any revenue generated from the sale of certificates. This can further prevent the uptake of new opportunities as well as existing activities. For example, the PIAM&amp;V method can be expensive to implement.</p> <p><b>Industry capacity</b> The capacity of industry to transition to new opportunities may also depend on their ability to meet the technical and compliance requirements of the scheme. There may need to be capacity building to enable industry to participate in the schemes depending on the nature of the rules and methods that support the scheme.</p> <p>A potential way of enabling new opportunities could be to consider the use of ‘regulatory sandboxes’ to enable time limited, risk controlled testing of these innovations.</p>
<p><b>Penalty rates and exemptions (page 16)</b></p>	
<p><b>17.</b> Is the current penalty rate set at an appropriate level to incentivise retailers to buy and surrender certificates?</p>	<p>The current penalty rate appears to provide sufficient incentive to retailers to buy and surrender certificates in order to meet their individual energy savings targets. IPART notes that the vast majority of energy providers, and indeed the overall energy savings target is met through the surrender of energy savings certificates (ESCs). For instance, in the 2019 compliance year, 97%</p>

	<p>of the energy savings target was met through the surrender of ESCs, with 2% carried forward and only 1% of the target met through an election to pay the penalty rate.</p> <p>In IPART's view, the penalty rate should continue to be set by reference to Department modelling with clear guidance provided to participants about when and how penalty rates and targets are reviewed.</p>
<p><b>18.</b> Should small retailers be exempt? If so, up to what size?</p>	<p>We consider there should be an exemption for small retailers. This will assist with reducing red tape (largely cost) burdens and minimising barriers to entry for new players. Compliance and other administrative costs can be disproportionately burdensome on smaller retailers. Once retailers reach a certain size this burden becomes non-material as the fixed cost can be spread over a larger customer base.</p> <p>The exemption should be set at a known threshold to ensure consistency in approach across jurisdictions. Adopting a threshold similar to the Victorian threshold would provide this consistency.</p> <p>It is important to ensure that any exemption is robust to ensure consistency and transparency. Conditions should be included to deter participants from effectively "gaming" the system to benefit from the exemption.</p>
<p><b>The NSW Government will expand fuel switching activities (page 21)</b></p>	
<p><b>19.</b> Which cleaner fuel switching activities should the scheme provide incentives for?</p>	<p>IPART supports the ongoing allowance of fuel switching where this represents a true energy efficiency activity – for example, displacing gas or electricity by the use of waste gas, waste wood, and by-products like black liquor that have come from within the same industrial process. This is part of the production process so represents a true reduction in energy consumption. We note that this already happens on a limited basis.</p> <p>If the Department wants to encourage fuel substitution that does not result in energy savings (eg replacing gas with hydrogen or biomass that is generated outside of the industrial process),</p>

	IPART considers that this would be better facilitated by a parallel scheme with a different metric for certificate creation, such as “carbon dioxide equivalent” which is an internationally recognised definition of greenhouse gas.
<b>20.</b> Should the scheme cover technologies that are being wound down under the SRES? If so, what is the best way to do this?	We consider this would be hard to implement in a way that would ensure additionality.
<b>21.</b> How should energy savings be counted for these cleaner fuel switching activities?	See our response to <b>question 19</b> . IPART’s view is that only the energy savings not the volume of fuel switched should be counted.
<b>23.</b> Under what circumstances should the NSW Government consider extending scheme liability beyond the electricity sector?	<p>We assume this question is referring to whether it would be appropriate to extend scheme liability to gas retailers. There would be some logic to this approach given gas efficiency activities were added to the scheme in 2015 and there would be value in circumstances where it appeared that cross-subsidy from electricity to gas consumers was occurring at a material level.</p> <p>However, it does not yet appear that this is happening – the extent to which electricity consumers are subsidising gas consumers is not great and the vast majority of energy savings under the current scheme occurs in electricity consumption, not gas.</p> <p>One option could be to apply a liability on gas retailers based on the level of the previous year’s gas energy savings. However, the disbenefits of complexity and uncertainty would probably outweigh any discernible price benefits for electricity customers.</p>
<b>The purpose of a peak demand reduction scheme (page 25)</b>	
<b>24.</b> How can the scheme’s certificates best capture capacity, timing, duration and availability factor?	Please refer to <b>Attachment B</b> for a detailed analysis of this issue. IPART’s view is that activities that relate to peak demand response (eg devices that can be remotely turned down or off during peaks) or peak demand shifting (eg batteries) are likely to be more effective than activities relating to peak demand savings (eg energy efficient appliances).

	<p>Our view is that the certificates should relate to an actual effect of reducing peak demand – not merely the capacity to do so. We note that lessons can be learnt from existing capacity schemes in other jurisdictions, such as the Single Electricity Market in Ireland and its Capacity Remuneration Scheme.</p>
<p><b>25.</b> Who is best placed to manage the financial risk that capacity is not made available when needed?</p>	<p>In IPART's view, the certificate seller must bear this risk in order for the scheme to function effectively.</p>
<p><b>Eligible peak demand reduction activities (pages 31–32)</b></p>	
<p><b>28.</b> Are there alternative ways in which the peak demand scheme could complement national schemes?</p>	<p>IPART supports the view that the peak demand reduction scheme should be designed in such a way as to be complementary to actions being taken at a national level. There needs to be a way to roll up the peak demand reduction scheme once a suitable national scheme is in place and the scheme should be designed with that in mind.</p>
<p><b>31.</b> Should location-based multipliers or activities that are specific to certain locations be considered?</p>	<p>We note that some link to the location of activities is a common feature of similar schemes. For instance, under the SRES, the number of small-scale technology certificates that can be created per system is based on geographical location, installation date, and the amount of electricity in megawatt hours the system generates or displaces over the course of its deemed generation period.</p> <p>Any location-based multiplier would need to be able to respond to changes in, for example, network connectivity that could make a previously valuable location for an activity to occur of less value.</p>
<p><b>Establishing liability for the scheme (page 34)</b></p>	

<p><b>32.</b> What are your views on the proposed approach to scheme liability? Please align your response with the topics above.</p>	<p>IPART agrees with the Department in preferring:</p> <ul style="list-style-type: none"> <li>▼ option 2 for allocating the peak demand reduction scheme target (liability is based on total liable electricity purchases less exemptions)</li> <li>▼ option 2 for allocating individual targets (target by proportion of contribution to the liable activities)</li> </ul> <p>We agree that these options should provide greater certainty to scheme participants and are the best options in terms of achieving consistency with the current ESS.</p>
<p><b>33.</b> What would be the implications for the available dependable peak demand reduction capacity in New South Wales if the scheme allows carry forward?</p>	<p>IPART supports the inclusion of a carry forward mechanism (for 12 months) as it provides some flexibility for scheme participants in meeting their obligations at the end of the compliance period and provides an alternative to penalty payments where there is a shortfall of certificates available. The carry forward mechanism is likely to have little to no impact on dependable peak demand reduction capacity for the following reasons:</p> <ul style="list-style-type: none"> <li>▼ The portion of the liability carried forward must be ‘made good’ in the following year. Therefore certificates are still being surrendered to meet the obligations, albeit in the following year. This is a better outcome than the alternative which is the payment of shortfall penalties where there is no obligation to make good following payment.</li> <li>▼ The key influences on available dependable peak demand reduction capacity will be setting an appropriate target and ensuring the certificate units are appropriately defined. Whether or not a portion of the liability is carried forward at the end of a compliance period should not impact the available peak demand reduction capacity as the activities will already have been implemented by the time the liability is carried forward and as such there should be no direct correlation between carry forward and number of certificates created (ie, it is very unlikely there would be less certificates created due to the fact that some scheme participants might elect to carry forward a portion of their liability).</li> </ul>

	<p>A key benefit of the carry forward mechanism is that it provides a level of flexibility for scheme participants to facilitate forward purchase agreements where the exact size of their liability is not known until the end of the compliance period. The carry forward can also assist retailers to manage cash flow issues – which may be of increased importance given uncertainties caused by COVID.</p> <p>The absence of a carry forward option could potentially incentivise some Scheme Participants to pay penalties to meet a portion of their liability, rather than purchase certificates. As such, <b>not</b> allowing carry forward could potentially have some impact on the available dependable peak demand reduction capacity.</p> <p>Experience with the ESS suggests that there may be value in reviewing the carry forward provisions after a certain time period – say 2-3 years. We note that in the first year of the ESS the maximum carry forward amount was 20% of the target, which was later reduced to 10%.</p>
<b>Peak demand reduction certificates (page 35)</b>	
<b>34.</b> What qualifications should certificate providers be required to have?	<p>Under the current ESS, certificate providers are not required to have any qualifications but are legally responsible for all actions, omissions and activities carried out by their contractors. It is a requirement that all representatives of the certificate provider must do “any training necessary to undertake an implementation” and they must meet “relevant legislative or regulatory requirements with which the representative must comply in performing its role”. Certificate providers must maintain a register of all their representatives including any formal qualifications, licenses and certifications (e.g. electrician, plumber). We note that adding qualifications beyond those required to undertake the work by other government regulation would increase barriers to entry to the scheme.</p> <p>The level of qualification required to participate in the new peak demand reduction scheme will be dependent on the activities that form part of the scheme. We consider that, as with the ESS, it should become the responsibility of the accredited person creating the certificate to ensure that</p>

	<p>their representatives and contractors are suitably qualified to carry out the work. A check on the qualifications of persons carrying out the work could form part of the audit scope.</p>
<p><b>35.</b> Should certificates expire every compliance year or should they be transferable to future compliance years? What implications would your preferred approach have for ensuring dependable peak demand reduction capacity in New South Wales?</p>	<p>IPART considers that there is value in imposing an expiration date on certificates, however we do not think that 12 months is an appropriate period of validity.</p> <p>Putting an expiry date on certificates would help ensure that targets in a particular year are not met by activities undertaken some years ago. From an administrative perspective this has an added advantage in that it ensures certificates do not exist in perpetuity – which has happened with certificates generated under the GGAS, which closed in 2012 and where there are almost five million certificates unsurrendered in the ESS Registry.</p> <p>However the expiration period needs to be balanced against other impacts on the scheme and certificate market. We do not consider that annual expiration of certificates is viable as this would risk a shortfall in the number of certificates created – meaning scheme participants would meet their liabilities through payment of penalties rather than through the creation of peak demand reduction capacity.</p> <p>In terms of the risk that no expiry of certificates would lead to a certificate surplus and impact the available peak demand reduction capacity, it is worthwhile noting trends in the ESS to date. Even with an ongoing surplus of certificates equivalent to an entire year's target, certificates continue to be created in response to the ongoing demand created by the scheme. This suggests that a well-designed scheme will continue to drive the uptake of activities and the creation of certificates will continue to occur regardless of whether there is already a number of certificates available to meet the target for a compliance year.</p>
<p><b>Achieving excellence in administration and regulation (page 37)</b></p>	
<p><b>36.</b> What is working well with the administration and regulation of the ESS? What features would you want to see</p>	<p>There are a number of key features that are necessary to support the integrity of the new schemes. These include:</p>

<p>continuing, and potentially replicated for the peak demand reduction scheme?</p>	<ul style="list-style-type: none"> <li>▼ Rules that are clear and enforceable to support strong accountability and transparency.</li> <li>▼ Consistency and fairness in the administration of the scheme.</li> <li>▼ Clear enforcement powers to support a modern and robust compliance framework.</li> <li>▼ An integrated IT system that combines the existing ESS Registry and Portal and supports both schemes.</li> </ul> <p>There should be a common regulatory framework that supports both schemes. This includes the integration of systems and processes as far as possible. This will ensure consistency for stakeholders and minimise the risk of duplication across the schemes.</p> <p>IPART has developed a robust compliance framework, systems and processes, applies a risk-based approach, and aims for fairness and consistency in our methodology and decisions. We will continue to apply the same principles in the regulation of the new schemes.</p>
<p><b>Development, implementation and review of rules (page 38)</b></p>	
<p><b>37.</b> Should the annual Rule review and three-year major Rule review process for the ESS and new peak scheme be changed or is it working effectively? Please provide an explanation for your response.</p>	<p>IPART considers that there is further scope for improvements to the Rule review process. We support structural changes to the layout of the Rule. These changes should ensure that the Rule is clear and readily understandable as well as streamlining the amendment and review process. Formally codifying the Rule change process so all stakeholders understand the process and timing is one option that would assist in providing greater certainty.</p> <p>We note, however, that as new activities and technologies emerge it can be difficult to apply the current rules and there is often a lag before changes can be made. To manage this and quickly address issues that might arise in the application of the Rule we suggest two improvements to the Rule review process.</p>

	<p>The first is faster processing of low-risk rule change requests. This could enable minor and non-controversial changes to rules to support new activities or technologies, or alternatively address issues that might arise in the application of the Rule. This could occur outside of the cycle of the annual review and be governed by set criteria to ensure ongoing certainty for industry. We note that the AEMC has a fast track rule change process, allowing the Commission to expedite the rule making process if the request is for a non-controversial or urgent rule (these terms are defined in the legislation). Under the expedited process there is only one round of written consultation on the rule change and no draft determination is made. A final determination must be made within eight weeks of commencement of the rule change.</p> <p>Secondly, we think that the Rule (or Regulation) should be amended so as to provide IPART with a power to issue binding guidance material. This would enable us to quickly address issues that might arise in the application of the rules, without needing to wait for the next Rule review. It would mean that action could be taken against service providers that failed to comply with the guidance document. There is precedent for this approach – clause 7A.16 of the ESS Rule provides that IPART may publish PIAM&amp;V Method Requirements, and that contravention of these Requirements is a contravention of the Rule. We note that the need for IPART to quickly address unforeseen loopholes and complications is likely to increase with the introduction of the new peak demand response scheme.</p>
<p><b>38.</b> Would the above ideas help make the Safeguard more customer-centric? Do you have other suggestions?</p>	<p>Care needs to be taken with the concept of ‘customer-centric’ when referring to a regulatory scheme. The ultimate customers of the Energy Security Target and Safeguard are the people of NSW and the schemes should be designed with a view to ensuring they deliver on their objectives in a manner that delivers a net benefit and value for money, not to ensure the satisfaction of scheme participants and service providers.</p> <p>However, IPART agrees that systems, including online systems, created to support compliance with regulations and rules should be cost-effective, easy to use, and reduce unnecessary administrative burden. This is consistent with Government efforts to make it ‘easier to do business’ in NSW.</p>

	<p>We support the ideas outlined on p 38 of the issues paper and we consider that these will help facilitate the efficient operation of the Safeguard. In particular, options for integration of the ESS portal and ESS Registry and improvements to these systems are already underway, and will be a priority to have in place before commencement of the Energy Security Safeguard.</p> <p>While IPART is supportive of robust consultation processes on proposed Rule changes, we note that currently such consultation is undertaken by the Department, not IPART.</p>
<b>Scheme participants and service providers (page 39)</b>	
<p><b>39.</b> What improvements could be made to the administration and regulation of the ESS that would encourage the creation of effective energy saving activities? Please provide an explanation for your response, including an indication of your key priorities.</p>	<p>IPART considers that the key priority should be simplifying the ESS Rule. Clearer Rule drafting will help reduce barriers to entry to the scheme and make it easier for participants to comply with requirements.</p> <p>There would also be benefit in clearly defining for stakeholders the role of IPART as Scheme Administrator and Regulator and the Department's role as policy maker. We note that confusion about the roles can create confusion and frustration with stakeholders which could be resolved if the different functions were made clearer. The distinction between Administrator and Regulator is an added complexity and can be confusing for stakeholders. It could be removed so that Scheme Regulator and Administrator becomes a single role.</p> <p>In addition, it would assist to clarify what functions are included in the role of Regulator. As Regulator, IPART has a clear role in providing general information and guidance tools so that stakeholders can make informed decisions about compliance. This is different to providing individual advice to stakeholders on a case by case basis, effectively acting as a consultant. To do so would undermine our independence as a regulator and compromise our ability to later take action against non-compliances. It is ultimately the responsibility of Accredited Certificate Providers and Scheme Participants to make informed decisions and manage their own compliance obligations</p>

	<p>Another improvement could be to provide a fixed time period for certificate creation (eg 12 months from the implementation date), rather than requiring creation by a specified date (currently 30 June). This would remove the peaks and troughs associated with certificate creation, and provide an equal time for each project (the current ESS Rule provides between 1 day and 18 months). A similar rolling 12 month deadline for certificate creation could also be established for the peak demand reduction scheme.</p>
<p><b>40.</b> Who should be responsible for developing the capability of service providers to deliver effective activities, the Scheme Administrator or the Department?</p>	<p>Different parties need to be involved depending on the capability that needs further development.</p> <p>IPART as Scheme Administrator determines the form and manner of a number of application processes and also the evidence requirements that service providers must meet to demonstrate compliance with the legislation. It is appropriate for the Scheme Administrator to develop the capability of service providers to understand and meet these processes and requirements so they can deliver effective activities and be compliant with the schemes.</p> <p>The Department has a role in developing knowledge of the scheme more broadly and promoting the scheme so businesses and the community can successfully participate in the scheme.</p> <p>There is also a role for service providers and their representative bodies (eg Energy Savings Industry Association) to develop their own capability and compliance within the industry.</p>
<p><b>41.</b> What is the best way to develop the capabilities of service providers?</p>	<p>As discussed above, different capability gaps are best addressed through different parties and different means.</p> <p>IPART currently uses a number of methods to develop service provider capability to identify and understand their obligations and improve their practice. The methods used include guidance materials, education and engagement. We are currently working on improvements to these methods including:</p> <ul style="list-style-type: none"> <li>▼ detailed guidance material published on IPART's website is currently being reviewed and streamlined</li> </ul>

	<ul style="list-style-type: none"> <li>▼ online workshops for service providers and applicants are being converted to digital format to allow on-demand access</li> <li>▼ regular stakeholder forums designed for an open dialogue between IPART and its stakeholders are being held more frequently</li> </ul> <p>Some of the options proposed in the consultation paper, for instance the suggestion of early 'eligibility checks' by IPART, would require significant additional resourcing to be implemented effectively.</p> <p>Consideration should be given to whether it is most appropriate for Government (and ultimately the people of NSW) to absorb this cost and bear the risk or whether service providers, who are profiting from the scheme, should bear the risk.</p>
<b>Administrators and regulators (page 41)</b>	
<b>42. What are your views on the options to enhance the compliance and enforcement framework of the ESS?</b>	<p>An effective regulatory framework relies on the regulator having appropriate compliance and enforcement powers. IPART supports the need for enhanced powers to ensure the ongoing integrity of the schemes.</p> <p>A civil penalty regime would complement existing provisions for penalty notices and court prosecutions. IPART agrees that such a regime would better allow for financial penalties to be issued to reflect the seriousness of the non-compliance as well as providing an alternative to the current penalty notice provisions.</p> <p>The powers set out in the options in Table 5 are consistent with the powers of a modern regulator and align with the powers of other regulatory agencies in NSW as well the Victorian Essential Services Commission. IPART supports the need for expanding the current compliance powers to enable it to deliver best practice risk-based compliance and enforcement activities.</p>

	<p>See <b>Attachment C</b> for detailed responses to the options set out in Table 5.</p> <p>We note that the current distinction in the legislation between the Scheme Administrator and the Scheme Regulator (both roles of IPART) does not enhance the compliance and enforcement framework in any way and can cause confusion for scheme participants and certificate providers. Removing this distinction would be one way to simplify the regulatory framework.</p>
<p><b>43.</b> Are the current provisions for the NCAT review of decisions by the Scheme Regulator and Administrator sufficient? Please provide an explanation for your response.</p>	<p>IPART considers that current arrangements for the administrative review of decisions by the Scheme Regulator and Administrator are effective. The ability to seek a review of decisions promotes accountability by giving stakeholders an avenue to have decisions scrutinised and reviewed by an independent third party.</p> <p>However, the level of awareness concerning internal and external review opportunities varies among applicants, accredited certificate providers and scheme participants. Accordingly, as part of IPART's commitment to best practice regulation, we are engaged in an ongoing program to improve the accessibility and clarity of IPART's written material and communications to ensure that participants are aware of their avenues of review.</p>
<b>Government (page 41)</b>	
<p><b>44.</b> What key performance indicators and service standards should be considered for the Scheme Regulator and Administrator?</p>	<p>IPART considers that the identification of relevant key performance indicators and service standards needs to wait until after the details of the Energy Security Safeguard are clearer and it is therefore known what IPART would be regulating. We would like to work further with the Department on developing suitable performance indicators and service standards.</p> <p>It is important to ensure that any KPIs developed do not drive unintended consequences such as poor decision making to meet deadlines. This is particularly relevant in the context of compliance matters where decisions must be made based on relevant circumstances rather than the need to meet KPIs. It is therefore anticipated that any KPIs would encompass things like expected timeframes for enquiries and routine tasks (eg, application assessments and audit assessments).</p>

## Attachment B

### Targets and penalties for the existing Energy Savings Scheme

The Energy Savings Scheme was designed to solve two problems:

- ▼ Environmental externalities are not priced, so energy consumers do not fully factor environmental consequences into their decisions about energy use, and
- ▼ Energy consumers do not exploit all the available energy saving opportunities because of incomplete information and incomplete markets.

The Scheme addresses these problems by imposing a tax on energy use that can help to internalise the environmental externality, and by creating a financial incentive for business intermediaries (the Accredited Certificate Providers, or ACPs) to help energy users overcome the impediments to adopting cost-effective energy savings activities.

This tax will make energy prices higher than they would otherwise have been. For this reason, it is very important that the level of that tax is no higher than necessary to achieve the scheme's policy aims. The level of the tax is driven by two aspects of scheme design: the target and the penalty rate. The higher these are set, the higher the tax. There will be an optimal setting for both. Setting targets and penalties too high will damage the economy: consumers will pay more than necessary for energy, they will curtail productive energy-using activity and the economy overall will contract unnecessarily.

The tax is imposed on energy retailers and certain other large energy consumers (the Scheme Participants) by requiring them to purchase and surrender a target number of certificates (each one representing 1 MWh of energy savings) each year. Certificates are created by ACPs by generating or facilitating energy savings beyond a given baseline. These certificates are freely tradeable, and the market for certificates determines the price. Market pricing is an attractive feature of the scheme because it helps to ensure that energy savings are achieved for a cost-reflective price.

In the event that a liable Scheme Participant fails to surrender its required number of certificates, it must pay a penalty rate. The penalty rate is currently set at a level that approximately equates to the carbon price on the emissions of a coal-fired power plant in generating 1 MWh of electrical energy. It is very important that the penalty rate remains close to the external environmental cost of 1 MWh of energy. If it was set at a substantially higher level, then firms would undertake more energy savings than the efficient level and this could make the economy contract unnecessarily. Efficient energy-intensive activities would not be undertaken, and welfare would suffer.

Setting the target number of certificates to be surrendered each year requires some judgement. It must be done with an understanding of the energy saving opportunities available at any point in time. Setting a target that is far above the available opportunities would cause one of two problems. On one hand, it could mean that the target is not achieved and that Scheme Participants are forced to pay the penalty rate on a substantial part of the target. On the other hand, it could lead to pressure to increase the penalty rate to a level that is far above the economic level—which is the value of the environmental

externality. This increasing penalty rate scenario could lead to significant damage to the economy, far beyond the energy market.

In summary, the design of the existing Energy Savings Scheme matters very much to the energy market and to the economy more broadly. The two key design requirements are that:

- ▼ The penalty rate remains close to the external environmental cost of consuming one MWh of energy, and
- ▼ The target is set with a good understanding of the portfolio of available energy savings opportunities at prices that are below the penalty rate.

## Making the Peak Demand Reduction Scheme effective

The Government has signalled a desire to flatten the peak of the energy demand curve. It makes sense to do so, if it can be done without curtailing necessary economic activity. However, some measures that would flatten the peak could damage the economy, so it is important to incentivise peak reduction in a judicious way. Reasoning by analogy to public transport, it would be desirable to flatten the commuter peak. This could be done if people didn't get to work on time, but that would have flow-on effects throughout the economy.

The level of the demand peak determines the amount of energy infrastructure that must be provided. Depending on the shape of the load duration curve, some of that infrastructure may be unused for much of the time. The new Peak Demand Reduction Scheme (**PDRS**) recognises the opportunity to make savings in network and generation investment costs over the longer term if the load duration curve can be modified to be less peaky.

The key measure of peakiness is the ratio of maximum to average demand. The PDRS will be successful to the extent it succeeds in reducing that ratio from its current level and sustaining that reduction for a long enough period that infrastructure investments can be adjusted.

The proposed PDRS relies on certificates that liable parties would be obliged to purchase and surrender. Certificate creation will depend on success in modifying the load duration curve to make it less peaky, as measured by the ratio of maximum to average demand.

Great care must be taken in the design of these certificates, because the PDRS creates many new problems of measurement, attribution and verification of effect. While it is possible to measure changes in the ratio of maximum to average demand, it is far more difficult to attribute that effect to the actions of particular agents, and even more difficult to be confident that a reduction in one year will be sustained over the longer term.

The consultation paper lists three types of activity that could contribute to peak demand reduction:

1. Peak demand savings
2. Peak demand response
3. Peak demand shifting

Of these, peak demand savings (for example, through energy efficient devices such as refrigerators and air-conditioners) are less well suited to incentivisation through the PDRS. These devices will already receive a level of subsidy support through the Energy Savings Scheme and potentially other Federal schemes. Including them in the PDRS would risk double-counting the savings and involve considerable administrative complexity to avoid overlaps.

Peak demand response (for example through devices that can be remotely turned down or off during peaks) and peak demand shifting (for example through batteries or Electric Vehicle charging strategies) could potentially make a real contribution to reducing the ratio of maximum to average demand.

We note that the consultation paper suggested the PDRS reward capacity investments. In our view, that approach would be problematic because the creation of capacity is no guarantee that it would be used when needed to reduce the peak. Capacity markets for electricity generation have been trialled in several jurisdictions overseas, but it has a number of well-documented shortcomings.

The consultation paper recognises that there may be times when peak-reducing capacity may be unable to be used. For example:

- ▼ Demand management schemes in which the energy users opt not to reduce their consumption when requested, and
- ▼ Energy storage devices that are not capable of peak shifting because, for example, batteries are not charged when their contribution is required.

The consultation paper goes on to suggest that issues of this sort could be managed through the use of typical availability ratios that would discount the 'boilerplate' capacity of an investment for a historical average availability level. One of the many problems with this approach is that if capacity is rewarded, the certificate creators will have strong incentives to game the system by making the capacity available at less than the historical average level. The problem is that there is no way to guarantee that historical availability ratios will continue to be maintained.

In our view, it is vital that the reward under the PDRS must be for effect, not for mere capacity unless there is an ironclad guarantee that the capacity will be available when requested. The liability for non-performance must be on the certificate creator, unless a whole new type of moral hazard is to be created by this scheme.

The objection could be made that it will be hard to motivate PDRS certificate creators unless they are rewarded for capacity. However, the experience with the electricity generation market is that forward contracts can be used to help investors to raise capital investment funds on the strength of recurrent payments.

There are two further issues with a state-based PDRS. First, it may be very difficult to accurately attribute peak reduction effect to activities that earn NSW certificates when there are parallel schemes in place at the national level that also work to reduce peak demands. There are three examples of schemes at a national level that encourage and/or integrate demand side response in the NEM:

<https://www.aemc.gov.au/rule-changes/wholesale-demand-response-mechanism>

<https://www.aemc.gov.au/rule-changes/demand-management-incentive-scheme-and-innovation-allowance-tnsps>

<https://www.aemo.com.au/consultations/current-and-closed-consultations/demand-side-participation-forecast-methodology-consultation>

It is too early to conclude that the whole demand response mechanism, in particular, will not be effective in achieving efficient peak reduction.

Second, given the interconnections between state systems, if NSW did succeed in reducing its own peak demand while Victoria and Queensland did not, then that could give rise to some unexpected and undesired patterns of power flow across the interstate interconnectors.

In summary:

- ▼ Any PDRS certificates must be for effect in reducing the ratio of maximum to average demand against a clearly specified baseline, and not simply for the creation of capacity, unless that capacity is backed by a guarantee of use when needed
- ▼ Peak demand savings activities should not be rewarded under the PDRS, as they will be potentially rewarded under other schemes and double-counting is undesirable and administratively problematic
- ▼ Any state-based PDRS must be designed so as to complement existing national arrangements and facilitate a smooth transition to any future national schemes when they become operational.

## Responses to Table 5 – Compliance and enforcement options for the current ESS

Option	Response
The ability to hold ESCs pending the result of an audit.	<p>Mechanisms for Accredited Certificate Providers (<b>ACPs</b>) to set aside a percentage of Energy Savings Certificates (ESCs) pending audit is an important tool in managing the risk of improper creation of ESCs. It provides for an offset in the cases where a percentage of a batch of ESCs is improperly created and serves as an incentive to ACPs to only register ESCs that can be properly created.</p> <p>An amendment to the regulation to require all existing ACPs (together with newly accredited ACPs) to have enforceable undertakings to withhold up to 20% of ESCs may have the benefit of creating a more consistent approach to set asides and may be less resource intensive than managing set asides via individual deeds on a case by case basis. The benefits of a blanket approach in improving consistency and reducing ongoing administrative burden needs to be weighed against the benefits of a more nuanced and tailored approach that can be achieved through a system of individual deeds.</p>
The ability to gather and share relevant evidence and information effectively.	<p>It is common for regulatory agencies to have information gathering powers to enable them to effectively investigate potential compliance breaches. IPART supports the need for enhanced information gathering powers to align the current regulatory framework for the Energy Savings Scheme (<b>ESS</b>) with similar regulatory schemes in NSW and other jurisdictions.</p> <p>Equivalent investigation provisions under the <i>Victorian Energy Efficiency Target Act 2007</i> provides authorised officers of the Victorian Essential Services Commission powers to:</p> <ul style="list-style-type: none"> <li>▼ enter premises</li> <li>▼ search premises</li> <li>▼ examine activities on the premises</li> </ul>

	<ul style="list-style-type: none"> <li>▼ take photographs or video or audio recordings or sketches</li> <li>▼ inspect any document</li> <li>▼ take extracts from or make copies of that documents</li> <li>▼ take necessary equipment and materials onto the premises</li> <li>▼ secure a thing that is found in the exercise of the above, and</li> <li>▼ require a person to answer questions and produce documents.</li> </ul> <p>In NSW many regulatory agencies have similar powers that allow officers to enter premises, inspect and seize relevant records and items, ask and require answers to questions (subject to self-incrimination provisions) and to request information in writing. See for example Part 2A <i>Fair Trading Act 1987</i>, Part 4 <i>Gaming &amp; Liquor Administration Act 2007</i>, Chapter 7 Part 2 <i>Water Management Act 2000</i>.</p> <p>The ability for a regulator to deliver best practice risk-based compliance and enforcement activities relies on having an effective suite of powers and tools to act across the compliance continuum. Improved investigation powers allows for better targeting of serious, wilful or repeat non-compliant conduct, which in turn enables a lighter touch approach to the majority of service providers that are doing the right thing.</p> <p>Effective regulation also relies on adequacy of information sharing amongst regulators. Many service providers operate in other jurisdictions most notably under the corresponding Victorian Energy Upgrades program. Many compliance issues may also involve potentially illegal conduct not directly related to the ESS. For example consumer protection issues, electrical safety issues or fraud. The ability to easily and confidentially exchange information with other regulators improves regulatory outcomes for the community.</p> <p>A provision which expressly allows for information exchange (despite any other Act or law of the State) and lists specific agencies for which information exchanges is permitted would improve the effectiveness of scheme administration and regulation. An example of such a provision can be found in section 9A of the <i>Fair Trading Act 1987</i>.</p>
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Take action against individuals responsible for non-compliance.	<p>IPART supports provisions which would allow for action to be taken against individuals, including directors and managers, installers or subcontractors. This may include taking action against directors in a personal capacity for serious offences, or taking action against individuals (as opposed to an ACP) in cases where those individuals may have been acting in contravention of the instructions of an ACP.</p> <p>Such provisions are common across a number of comparative regulatory schemes. They enable regulators to target compliance action at the appropriate individuals and improve the ability to achieve proportionate regulatory outcomes. This would add to the current powers to take action against directors or managers in section 184 of the <i>Electricity Supply Act 1995</i>.</p>
Managing risk of related entities' non-compliance.	<p>IPART supports mechanisms which clarify the existing position by expressly stating that the regulator can consider the compliance history of related entities in decision making processes and that provide for the regulator to consider actions against related entities in appropriate circumstances.</p> <p>This would enable appropriate action to be taken where related entities have for example, the same ownership or directorship. In these cases the risk factors are often similar. It is therefore appropriate that the compliance history of related entities be taken into account.</p>
Manage risk of companies entering external administration.	<p>IPART supports the power to suspend or cancel an ACP's accreditation in all external administration related scenarios.</p>
Prevent serial offenders from participating in the scheme.	<p>It is critical that the regulator have the power to take action against people that engage in or facilitate significant and sustained non-compliance under the ESS. This extends to all parties that operate under the scheme, not just ACPs.</p> <p>A power to suspend (or ban) a person from undertaking any activity in relation to the scheme for a specified period would be an effective tool to address non-compliance. The ability to suspend or revoke licences for non-compliance is common across other regulatory frameworks in NSW. IPART supports a comparative power for the ESS.</p> <p>This power could be made subject to merits review, and could impose a suspension for a period of time reflecting the seriousness of the conduct involved. ACPs should be notified of such orders and be prevented from involving suspended persons in any activity under the ESS. Breaching a suspension order should be an offence.</p>

	The ability for a regulator to deliver best practice risk-based compliance and enforcement activities relies on having an effective suite of powers and tools to act across the compliance continuum. An increased range of administrative powers, including the ability to ban individuals and companies, would complement civil penalties and allow the regulator to better tailor and target its regulatory responses.
Provide certainty on timing of ESC creation.	Any enhancements to legislation to improve clarity regarding critical dates within the ESC creation process is welcomed.
Have enough time to take enforcement action.	<p>The limitation period for commencing prosecution under the current legislation is currently two years from the commission of an offence. It is common across other regulatory frameworks in NSW to have a limitation period that runs from the date on which the regulator becomes aware of an alleged offence. This enables sufficient time for potential breaches to be properly investigated and for appropriate compliance action to be taken when necessary.</p> <p>IPART supports a change in the limitation period so that it runs from the date on which the regulator becomes aware of the breach. This would enable it to undertake targeted audits and investigations in appropriate circumstances.</p>