Australian Sustainable Finance Institute
Commonwealth Treasury

Submitted online.

Second Consultation – Australian Sustainable Finance Taxonomy

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Australian Sustainable Finance Institute's ('ASFI') second consultation phase on the *Australian Sustainable Finance Taxonomy* ('Taxonomy').

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

19. Does the firming advice adequately address the entity and system-level interactions related to firming activities in transition plans? Please provide any additional feedback on the advice, and where providing recommendations please include evidence.

The AEC considers the firming advice to be impractical and costly to comply with. The AEC's preferred position is for ASFI to follow the advice of the Australian Energy Market Operator's (AEMO) optimal development pathway ('ODP') and classify gas-powered generation as transitional, without any requirement to demonstrate it is part of a credibly transitioning portfolio of assets. ASFI could consider implementing a sunset clause on the classification of gas-powered generation as transitional, which would be informed by future changes to AEMO's ODP. The AEC's context and reasons for this position are explained below.

A useful starting point is South Australia – a state often cited as a first mover and successful example of a high renewable economy. It has just begun consultation on a policy mechanism to support firming capacity, including gas-powered generation. The South Australian Government says this is needed because "while renewable energy will form the backbone of the state's future power system, long duration firm capacity will continue to be needed as a shock absorber for long periods where weather-dependent generation cannot provide adequate supply".[1]

This policy development is consistent with the advice of AEMO. Under its Integrated System Plan ('ISP') ODP *Step Change* scenario, AEMO projects a need for about 15 GW of gas-powered generation to reach net-zero by 2050, which is expected to run as a flexible, strategic reserve capable of backing up renewable generation during periods of low sun and/or wind.

[1] South Australia Government, 'Firm Energy Reliable Mechanism – Proposed Scheme Design Consultation Paper', p15.

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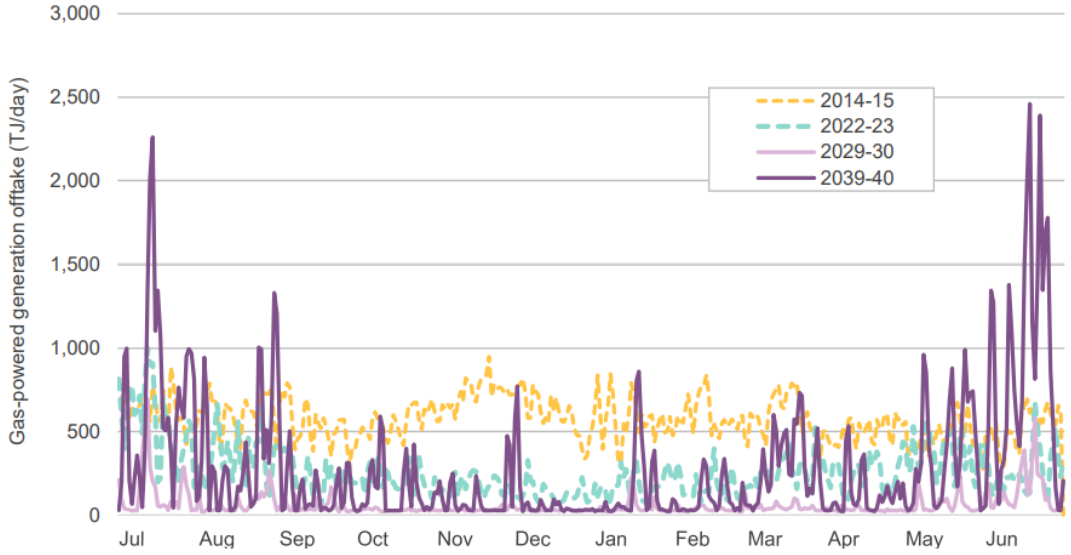
Figure 1: Gas-powered generation offtake, NEM (TJ/day 2014-15 and 2039-40, Step Change)



Source: AEMO Integrated System Plan, p70.

The ISP states this gas-powered generation will not run at full capacity, or even near it, instead mostly operating to perform a system need: a *typical gas generator may generate just 5% of its annual potential, but will be critical when it runs*.

ASFI noted this tension between activity-level and system-level performance of gas-powered generation in its first consultation and flagged its intent to later publish system-level guidance for the classification of gas-powered generation. The AEC welcomes ASFI's subsequent publication of that system-level advice.

Nonetheless, the system-level advice raises questions about whether this approach is really preferable to simply classifying gas-powered generation as transitional – which is consistent with the view of AEMO's ODP. The AEC considers that the practicality of preparing, communicating, and verifying system-level advice in what is a volatile investment environment has not been fully contemplated nor appreciated.

There are two, major practical challenges with the proposed firming advice.

1. **Inconsistency of 1.5C alignment vs 1.8C alignment**

ASFI says the purpose of the taxonomy is to encourage investment activity that enables emissions reductions in line with a 1.5C aligned economy. Most 1.5C electricity sector transition pathways have little role for new gas-powered generation. This is because they speculate the use of other technologies, which are currently unavailable, will or are expected to mature quickly enough to perform this firming role (e.g. hydrogen, long duration energy storage).

Rather than being imminently achievable, these pathways are generally seen as ambitious and something to work towards, subject to rapid technological developments.

The scenario that AEMO has designated as the optimal development pathway is its ISP *Step Change* scenario, which is 1.8C aligned. This means any investment activity that takes place in line with AEMO's ODP would not be compatible with the taxonomy since it is 1.5C aligned.

This misalignment between the taxonomy and the most credible transition pathway for the electricity sector creates confusion with respect to the *Key Considerations for Gas Firming in*

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Transition Plans. The advice in the taxonomy makes repeated reference to entity transition plans needing to make sure firming investment is 1.5C aligned. For example, the advice states: *If the system-level assumptions are not in line with 1.5°C then the firming capacity assumptions would also not be aligned*. This would mean that gas firming investment justified as part of AEMO's optimal development pathway would be inadequate to be classed as transitional.

At the 11 November webinar, ASFI clarified this misalignment and explained that reference to either scenario is acceptable: *system-level assumptions related to 1.5C scenarios and the ODP [Step Change] scenario (1.8C 'where relevant') may be used by an entity to demonstrate the basis for deploying firming capacity to enable further renewable energy penetration / provide system support*.

While this clarification is helpful, it creates confusion about how AEMO's optimal development pathway is being treated within the taxonomy. The ISP is generally considered the most authoritative planning document within the electricity sector and the reference point for almost all scrutiny.

It does not seem necessary for the taxonomy to produce its own system-level guidance about how gas-powered generation can be transitional, when it is clearly laid out in the *Step Change* scenario.

Furthermore, there are some misunderstandings and inconsistencies with respect to how gas-powered generation is characterised. Notably:

- The taxonomy says gas-powered generation has a "declining role" in Australia's electricity generation mix. While it is declining as part of total generation output, its role as a strategic reserve to support high renewable penetration is – according to AEMO - "critical".
- If the taxonomy can recognise that gas-powered generation will have a small generation output, then concerns about "carbon lock-in through the emissions performance of the whole activity" feels like a mostly theoretical exercise. The ISP *is* the system-level advice to ameliorate such concerns.

The AEC's preference is for gas-powered generation to be classed as transitional, consistent with AEMO's ODP.

Alternatively, AEMO's optimal development pathway (currently the *Step Change* scenario) should be the central scenario reference point in the *Key Considerations for Gas Firming in Transition Plans*. This would not preclude entities from going beyond this to show a 1.5C aligned company transition plan as a point of difference to attract investment.

2. Costs and administrative burden of verification of an entity's transition plan

ASFI has seemed to downplay the significance of the firming advice in the taxonomy on the basis that it is voluntary. However, in the absence of any other Australian taxonomy, it is expected that financiers and investors will increasingly rely on the taxonomy's classification to guide investment decisions. Treasury has also suggested an intent to mandate the taxonomy eventually.

Regardless of its regulatory status, companies looking to finance a gas-powered generation project are already being expected by investors to produce a credible Climate Transition Action Plan ('CTAP'), which includes portfolio carbon considerations. Placing further requirements to

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produce specific firming advice only adds a layer of burden and cost to entities for no clear additional benefit. Such auditing costs are unlikely to be small and may eventually flow down into customer bills.

If ASFI maintains that firming advice must be produced, then ASFI should consider how and by who would verify this advice as credible.

Aside from these two major practical challenges, there is the other complication of having a reliable gas supply and supporting infrastructure. AEMO's Gas Statement of Opportunities (GSOO) has already forecasted gas shortfalls in some NEM regions. ASFI should consider how its classification of gas exploration activity and infrastructure as "black" is compatible with enabling future investment in firming gas-powered generation.

18. Are the proposed TSC usable? In this context, usability of criteria refers to whether they are comparable, clear, objective and easy to understand. If not, please explain how they could be improved.

With respect to the Technical Screening Criteria for hydropower facilities, it is important that the taxonomy does not inadvertently exclude sustainable investment in existing hydropower plant.

The AEC suggests including an additional provision stating: "the electricity generation facility is a hydropower plant that complies with either the power density or emissions intensity criteria stated in A". There are two precedents that support this expanded definition:

- The sustainable use and protection of water resources criteria in the ASFI Consultation Paper (page 172) notes "refurbishment of existing hydropower plants and rehabilitation of existing barriers should be prioritised". Including this additional provision would incentivise the refurbishment of existing hydropower plants that are not PHES nor run-of-river.
- This change would be consistent with the provisions in the EU Sustainable Finance Taxonomy which classifies *any* hydropower plant where "the life-cycle GHG emissions from the generation of electricity from hydropower, are lower than 100gCO_2e/kWh" as green.

Furthermore, it is unclear how the taxonomy plans to treat electricity generation activities that are currently classified as green in the 2030 update to the taxonomy. The Consultation Paper notes that "the electricity generation activities that are currently included will remain eligible following 2030" but, in the hydropower technical screening criteria, confirms that the current emissions threshold will only be valid "until 2030".

It should be clarified whether currently eligible activities will automatically be classified as green in the 2030 taxonomy or if they will be subject to an updated emission intensity threshold.

2. Should the taxonomy provide guidance to lenders and users on the approach and expectations for evidencing alignment with the Do No Significant Harm (DNSH) and Minimum Social Safeguard (MSS) criteria? If so please provide suggestions on what guidance is needed.

The Minimum Social Safeguards (MSS) guidance will struggle to achieve outcomes for First Nations communities without explicit reference to sector-specific best practice. We recommend including a criterion that the entity actively engage with industry best practice related to First

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Nations communities and seek to follow those principles in its operations. We would point to the CEC Leading Practice Principles: First Nations and Renewable Energy Projects report as an example of a guide to sector-specific best practice.

7. Are the proposed TSC credible? In this context, credibility of criteria refers to whether a transparent, scientific approach aligned to the Paris Agreement temperature goal was used, informed by the latest technological understanding.

The AEC considers that renewable fuels including hydrogen, ammonia, biomethane and sustainable aviation fuels, should receive a green classification as a standalone activity within the electricity/energy section of the taxonomy. Even though the Australian economy is underpinned by energy, the current taxonomy is structured so that only specific applications of renewable fuels in mining and manufacturing activities can receive a green classification.

The classification of all renewable fuels as green within the electricity/energy section of the taxonomy would reduce ambiguity. The technology and market for these renewable fuels are still developing. It should not be the role of the taxonomy to pick winners with respect to what application of these fuels receive a green classification.

Any questions about this submission should be addressed to Rhys Thomas, by email Rhys.Thomas@energycouncil.com.au or mobile on 0450 150 794.

Yours sincerely,

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