Office of Energy and Climate Change
NSW Treasury

Submitted via email: renewablefuelscheme@environment.nsw.gov.au

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NSW Renewable Fuel Scheme

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to NSW Treasury's consultation on its *NSW Renewable Fuel Scheme – Scheme Expansion* ('Discussion Paper').

The Australian Energy Council 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.

As New South Wales moves closer towards its interim and long-term climate targets, decarbonisation opportunities in sectors other than electricity are gaining more focus. For sectors like stationary energy and light transport, there is growing policymaking consensus that electrification is a cost-effective and readily available low-carbon substitute. For heavy industry and transport and other hard-to-abate sectors, the pathway to net-zero is less clear.

The NSW Renewable Fuel Scheme seeks to create a decarbonisation pathway for hard-to-abate sectors by providing financial incentives for renewable fuels. To date, the scheme has focused only on encouraging green hydrogen production through a retailer-led certificate scheme. Commencement of this scheme has now been postponed to 1 January 2025 because of inadequate hydrogen supply.

This Discussion Paper subsequently provides a welcome opportunity to review the design of the scheme. Up until now, stakeholders have had limited chance to provide input into the scheme's design, with the original design elements placed in legislation without any public consultation or cost-benefit analysis.

In the AEC's view, the current scheme design is neither the most cost-efficient nor equitable way to decarbonise NSW's hard-to-abate industries. A retailer-led certificate scheme places the cost burden on gas customers to subsidise a hydrogen industry that will ultimately not benefit them. Moreover, having what is essentially a Renewable Hydrogen Target distorts market signals and discriminates against other renewable fuel types, including some like biomethane which have shown greater abatement potential to date.

Subject to a more equitable distribution of liability in line with a "beneficiary pays" principle, the AEC supports expanding the eligibility criteria, so all renewable fuels are treated neutrally. This will allow for competitive market pressures to determine what fuel has the most emissions reduction value.

Nonetheless, this Discussion Paper – while a step in the right direction – creates more policy questions than answers which need proper time to resolve. The stated intent to implement an expanded scheme design less than six months after the next consultation stage is rushed and will not give liable entities time to understand their obligations. It also seems unnecessary given there is no backlog of renewable fuel projects waiting for certification within the next year.

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

Treasury should consider either a later commencement of 1 January 2026, or implement transitional measures to minimise the flow-on costs to customers.

Better consultation is needed to improve the policy design

The regulatory framework for the NSW Renewable Fuel Scheme was legislated in 2021. At that time, there was no public consultation and stakeholders were not able to inform key elements of the scheme's design – such as the adoption of a retailer-led certificate scheme, the production targets, eligible activities, and liable entities. In contrast, Victoria's Renewable Gas Consultation Paper has actively sought stakeholder input to inform these different policy design questions.

The previous NSW Government did hold a targeted consultation process in early 2023 to discuss the regulations, but as the legislative framework was already established, there was little opportunity to shape the scheme and submissions were never made public.

Since then, there has been no update to the scheme or any response to stakeholder feedback, up until the announcement of the waiver of 2024 obligations in late September this year. While the AEC acknowledges that the change in government might have shifted policy priorities, this nonetheless should have been communicated to relevant stakeholders in a timelier manner given liable entities were facing compliance obligations with an unknown penalty price.

The subsequent waiver and Discussion Paper are welcome, but these have only been communicated to targeted stakeholders rather than publicly announced. The AEC considers the waiver needs to be clearly published via a formal legal instrument by the end of this year to provide regulatory certainty to liable entities regarding their compliance obligations. This can possibly be done when setting the penalty rates in regulations. If this is not possible, then the regulator – IPART – should provide clear notice on its website that there is no liability for 2024.

Furthermore, going forward the AEC would like to see a more transparent feedback loop, especially given this Discussion Paper is contemplating potentially fundamental changes to the scheme.

NSW Treasury should consider a 2026 commencement or other transitional measures

The Discussion Paper has helpfully laid out its timeframe for implementing these regulations, which will see another round of consultation in mid-2024 before legislation is in place at the end of 2024. Given these reforms may result in substantial changes to the eligibility of renewable fuels, the production target, and liable entities, the AEC does not consider a Q4 2024 decision point to be practical.

Gas retailers require lead-in time to factor in compliance costs into future retail contracts. The level of compliance cost will obviously depend on their liability under the scheme, which needs to be known well before Q4 if preparing for a 1 January 2025 commencement.

Likewise, allowing hydrogen producers to generate certificates from Q1 2024 introduces considerable uncertainty if the intent is to expand the scheme from 2025. It is not obvious who will purchase certificates in the absence of a firm regulatory framework and how policy questions related to fuel eligibility and exemptions can be resolved if hydrogen is already altering certificate demand.

Notwithstanding possible changes to how the target is set, early regulatory clarity is needed on the effect of the 2024 waiver. Specifically, whether compliance will now proceed with a one-year lag to the production targets (i.e. will the 2024 target now become the 2025 target?). It would seem unrealistic to postpone the 2024 compliance period because of there being inadequate supply to meet

Level 14, 50 Market Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 926 084 953 07

a 90,000GJ target and then expect liable entities to meet a 360,000GJ target (or its percentage equivalent) within a year, even with new fuels included.

While any transitional measures will depend on the final design, it could include initiatives like providing early projects with a production credit (similar to the Hydrogen Headstart program), as well as inserting provisions that allow for banking and borrowing by liable entities.

Scheme's objective should mention emissions reduction

Since the NSW Renewable Fuel Scheme was announced in 2021, it has been framed as a policy mechanism to support the NSW Hydrogen Strategy and encourage the production of green hydrogen, language which is embedded in the objective of the regulations.[1]

In the AEC's view, this language does not adequately reflect the reason for encouraging green hydrogen (or other renewable fuel production), which is to commercialise technologies that can reduce emissions, especially in otherwise hard-to-abate sectors, so NSW can meet its climate targets.

Given this Direction Paper is contemplating the redesign of this scheme, the natural starting point should be to rework the legislative objective to focus on cost-effective emissions reduction in hard-to-abate sectors. This should include phrasing to that effect: *the objective of this scheme is to incentivise production of renewable fuels to achieve cost-efficient emissions reductions, especially in heavy industry or otherwise hard-to-abate sectors*.

An objective clause that reflects the emissions reduction value of technology would assist in identifying which technologies should be eligible, as well as making clearer who are the beneficiaries of their production. Likewise, it better aligns with the principles contained in the NSW *Climate Change (Net Zero Future) Bill 2023* that climate action must be fiscally responsible and mindful of impacts to consumer costs.

Eligibility of renewable fuels

In its current design, the NSW Renewable Fuels Scheme is functioning effectively as a Renewable Hydrogen Target. The AEC has previously cautioned policymakers in other jurisdictions about the risks of such a policy,[2] which include:

- It is unreasonable and expensive to expect gas customers to stimulate and subsidise demand for hydrogen which will be predominantly used in other sectors (most likely international exports or heavy transport).
- It will distort the market by discriminating against other technologies that may be more cost-efficient and have better abatement value.
- The benefits of hydrogen providing firming services to electricity generation are unproven and far away, and there are other competitive technology options that deserve the same investment opportunities.

The AEC's principled position is that these risks are best mitigated by taking a technology-neutral approach that allows the market to determine which renewable fuels are valuable. Implementing a certificate scheme now when hydrogen and some other renewable fuels are still immature and unproven places an unfair cost burden on liable entities. It would be more equitable at this stage for the NSW Government to absorb these costs though initiatives like grant or pilot programs that support R&D (such as the NSW Decarbonisation Innovation Hub).

[1] For example, the *Electricity Supply Amendment (Renewable Fuel Scheme) Regulation 2021* states the object 'is to create a financial incentive to increase the production of green hydrogen and other renewable fuels'.

[2] Australian Energy Council, 'Western Australia Renewable Hydrogen Target', November 2022.

Notwithstanding this, given that a certificate framework is already legislated, the AEC's preference is for eligibility to be broadened to treat all renewable fuels neutrally. Maintaining technological neutrality will allow for competitive market pressures that can determine the most cost effective and efficient fuel, while setting a minimum liable demand will create growth opportunities for the most competitive fuels to scale.

It does not fully mitigate the inequitable subsidising of costs by gas customers, which may require a beneficiary pays approach to liability distribution.

Liable entities

A retailer-led certificate scheme was part of the scheme's original design, with the merits of this approach relative to other options never being subject to consultation, or cost-benefit analysis. It was likely chosen because it has been used elsewhere, most notably the Commonwealth Government's Renewable Energy Target ('RET'). While the RET has successfully accelerated deployment of renewable generation, it has come at a cost to small customers (about 10 per cent of the residential electricity bill).[3]

While the bill impacts here will be smaller, the challenge with a retailer-led liability scheme is that small customers do not necessarily benefit from the uptake of renewable fuels. The primary touted benefit for small customers is hydrogen blending being used in gas networks, but this is being increasingly challenged and many policymakers – as seen domestically in Victoria and the ACT – are now pursuing electrification as a more cost-effective and lower carbon substitute. Furthermore, electrification uptake will see the number of residential gas users decline, meaning the recovery costs of this scheme will increase and unfairly fall on those who remain connected to gas networks.

Consistent with the proposed revisions to the objective, the primary use of renewable fuels will be to decarbonise heavy industrial and hard-to-abate sectors. These uses include things like:

- Building up sources for sustainable aviation fuel, which provides the most realistic opportunity for decarbonising Australia's airline services.
- Providing off-grid power generation (e.g. renewable diesel) for Safeguard facilities like mining so they can meet their annually declining baselines.
- Clean fuel source to power heavy transport, like trucks and buses.

Other than biomethane providing a niche role in decarbonising households unsuited for electrification, small customers are unlikely to directly benefit from renewable fuel uptake. For this reason, the AEC would prefer to see a liability model that more equitably reflects the "beneficiary pays" principle. This should include making sure that self-contracting users (large industrial users that purchase directly from the wholesale market) are captured.

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,

Rhys Thomas
Policy Manager
Australian Energy Council

[3] ACCC, 'Inquiry into the National Electricity Market', November 2021, p4.