

CAPACITY INVESTMENT SCHEME – PUBLIC CONSULTATION PAPER

31 AUGUST 2023

INTRODUCTION

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

The EUAA support the pursuit of net zero targets but this must be achieved at least cost, not at any cost. In addition to least cost, we seek a transition to net zero where costs and risks are allocated equitably and where the energy system continues to deliver reliable energy services. It is by doing these things that consumer social licence for the transition will be maintained. If costs spiral out of control and the energy system becomes unstable and unable to deliver a reliable service, then this social license will be lost.

The EUAA welcomes the opportunity to make a submission to the Capacity Investment Scheme (CIS) Public Consultation Paper (Consultation Paper). Our comments will be relatively brief given it is clear that most of the key design decisions have already been made and that the initial round of CIS auctions has already commenced¹.

SPECIFIC COMMENTS

Identified Need

It is clear that the deployment of dispatchable capacity must be accelerated if we are to achieve the objectives we have identified in the introduction to this submission. Recent reports of significant cost escalation and material delays in large, long duration dispatchable capacity such as Snowy 2.0² and potential delays in Marinus Link³ that will connect pumped hydro resources in Tasmania is concerning. It is clear that state governments are equally concerned, and we have recently seen the Victorian Government acting to ensure existing thermal generation remains in place until such time that equivalent dispatchable resources are in place⁴.

¹29 July 2023 media release announcing commencement of the CIS with first tender process in NSW

<https://minister.dcceew.gov.au/bowen/media-releases/joint-media-release-capacity-investment-scheme-power-nsw-clean-cheap-reliable-energy>

² Snowy 2.0 has been plagued with project delays and cost blow outs with the most recent issues raised in early May 2023 <https://www.afr.com/companies/energy/snowy-2-0-faces-further-cost-increases-delays-20230503-p5d54v>

³Marinus Link is a well advanced project and has already received significant state and federal assistance, yet it is still suffering from significant uncertainty <https://www.abc.net.au/news/2023-08-04/marinus-link-tasmania-energy-project-cost-blowout-warning/102688864>

⁴This is the second confidential deal the Victorian Government have done with a thermal generator. Ironically Victoria have rejected gas as part of the CIS <https://www.theage.com.au/national/victoria/taxpayers-face-bill-for-early-coal-closure-for-agl-s-loy-yang-a-20230821-p5dy5d.html>

In previous submissions on this topic, the EUAA were open to the introduction of a well-designed and targeted capacity market that could sit alongside a well-managed exit strategy for old thermal capacity. Unfortunately, this approach was derided as “coal keeper” by some groups⁵ and the approach was scrapped.

It is quite ironic that state jurisdictions now have little choice but to underwrite ageing thermal assets to ensure system strength and reliability. This may result in coal staying longer in the system than otherwise would have occurred. The difference between the former approach and the approach governments are forced to pursue is that the former would have been delivered via an open, transparent and (hopefully) efficient market while that latter is being pursued via confidential arrangements between governments and asset owners. The saving grace is that the latter approach takes the costs and risks onto the government balance sheet, so it is taxpayers, not energy users who carry the cost and risk. While this may shield energy users from some market impacts it is far from an orderly process.

There is universal agreement on the need, but issues associated with identifying the specific problem to be solved (specifically the duration of capacity required) and the best way to address it (market, government or hybrid) are still open questions in our mind, although recognising governments have chosen, for the immediate future, to take a direct role.

Problem Identification

In our previous submission to the Capacity Market High Level Design Paper (25 July 2022) we made the following observations that remain relevant to the CIS:

“The current EUAA view is that short duration capacity, or intra-day capacity gaps (i.e. up to 4 hrs), may well be met with existing (FCAS) and emerging (ESS) market settings (along-side energy market revenue) and that a capacity payment would simply represent an over-payment to those technologies. Our current view therefore is that the true problem is the longer duration (6+ hrs), or inter-day capacity gaps that may continue to emerge.”

“Challenge an approach where encouraging the deployment of batteries (either via capacity payments or subsidy scheme) with an export duration of 2-6 hours will alone resolve the longer duration gaps in supply and reliability that are emerging. The AEMO 2022 ISP calls for 10GW of gas generation as part of a broad portfolio of technologies (including pumped hydro) to meet the future energy market needs which highlights the need for a technology neutral approach.”

The need to re-consider the Market Price Cap (MPC) should a capacity market be introduced is a strong theme amongst energy users. A high MPC is designed to send a price signal for new investment. If a capacity market is designed to fulfil this role (providing a large part of the investment signal) then a lower MPC should follow. We are of the view that maintaining a high MPC along-side a capacity market has the real potential to deliver windfall gains to all generators. We recognise that lowering the MPC may create issues for existing assets who are excluded from the capacity mechanism as they would no longer be able to access

⁵ There is no doubt that coal would have been supported under previous proposal, but it would have also managed their exit. <https://www.climatecouncil.org.au/resources/strongenergy-ministers-say-good-riddance-to-coalkeeper-and-yes-please-to-renewables-strong/>

a higher wholesale price that was relied upon to underpin their initial investment. One solution could be to consider a split MPC, where those taking capacity payments access a lower MPC, while those who do not receive capacity payments access a higher MPC.

We remain concerned that the CIS will tend to support relatively short duration storage. While this may be acceptable within the context of recent life extensions of existing thermal generation, further work must be done to ensure inter-day capacity gaps are met. In particular we are yet to understand how the required 10GW of gas generation will participate in an environment where short duration capacity continues to be underwritten by the CIS.

We also need to better understand how the CIS will interact with other measures, both existing and proposed. For example, we would welcome a discussion about the MPC as it relates to those assets that are underwritten by the CIS and if they should remain eligible to receive the full value of the MPC. We would also welcome a discussion on how the CIS interacts with FCAS markets (given the assets deployed are capable of provide capacity and FCAS) and the proposed Operating Reserve Market.

The CIS Mechanism

We see merit in the proposed CIS mechanism and absent other market-based alternatives, support the underwriting nature of the scheme. The EUAA was a member of the NSW Roadmap Consumer Reference Group that worked closely with the NSW to ensure the LTESA framework, on which the CIS is based, protected consumers from a degree of market risk while delivering on Roadmap objectives. Central to this work was to strive for a high degree of transparency of both the process and outcome.

The CIS, with its revenue floor and ceiling, is a further enhancement on the LTESA framework. As with NSW LTESA where the strike price is critical feature for managing consumer risk, the value of the floor and ceiling will be critical for managing the risks that taxpayers will be taking. While this is important for taxpayers to understand, it is also critical for other market participants to understand as it may have impacts on future investment decisions. Therefore, we encourage a high degree of transparency around these values.

Finally, we would also encourage the deployment of technology that does not negatively impact system strength. For example, if the CIS is supporting the deployment of battery storage there must be a requirement they are grid forming, not grid following batteries.

Once again, thank you for the opportunity to participate in this process. Do not hesitate to get in contact should you have any questions.

Sincerely,



Andrew Richards
Chief Executive Officer