

CAPACITY INVESTMENT SCHEME IMPLEMENTATION DESIGN PAPER

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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. Additionally, we seek an equitable allocation of the costs and risks associated with the transition as all too often energy consumers are expected to carry the heavy weight of market (i.e. shareholder and/or debt providers) risk that should sit with market participants. We firmly believe that this transfer of risk is inconsistent with the NEO.

The EUAA welcomes the opportunity to make a submission to the Capacity Investment Scheme Implementation Design Paper (the Design Paper) and look forward to continuing engagement on the development of this important policy.

PREVIOUS SUBMISSIONS

In our 31 August 2023 submission to the Capacity Investment Scheme (CIS) Public Consultation Paper (Consultation Paper) we expressed concern that:

“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.”

Recognising that the current version of the CIS has significantly expanded objectives both in scope and scale (23GW of generation and 9GW dispatchable capacity) we remain concerned that dispatchable capacity aspect of the CIS

will tend to support relatively short duration storage (i.e. 2-6-hour batteries). 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 16GW of gas generation identified by AEMO in the draft 2024 ISP¹ will participate in an environment where short duration capacity continues to be underwritten by the CIS. While we don't address this question in this submission, there is an urgent need to resolve this issue, especially given the accelerating pace of fossil fuel asset closures.

POLICY OPTIONS – VRE DEPLOYMENT AND 82% BY 2030

The federal government target of 82% renewable energy by 2030 was always ambitious, even before world events profoundly impacted international supply chains and escalating costs driven by a global decarbonisation race. We understand the pressure on the federal government to provide more “policy support” for the deployment of renewable energy technologies. In particular the push to significantly expand (both in scale and timeframe) of the consumer funded Large-Scale Renewable Energy Target (LRET).

We estimate that the current consumer funded subsidy for the LRET amounts to approximately \$1.65 billion per annum². Over the full course of the federal scheme (commenced in 2000 and concluding in 2030) the total consumer funded subsidy for large scale renewable energy is estimated to be \$30 billion. This does not include the costs associated with the Small-Scale Renewable Energy Scheme (SRES), state-based incentives, transmission augmentation, system strength remediation, storage etc, a vast majority of which ends up on consumers energy bills.

Renewable energy is in a very strong position to continue its march forward. As a result of the extended period of policy support described above, renewable energy has come to dominate the energy investment environment. According to the most recent CSIRO GenCost Report³, renewable energy represents the least cost energy generation technology (on an LCOE basis) even when transmission⁴ and firming costs are included. It is clear that renewable energy is the favoured technology by investors and that there is a strong commitment from government to drive the rapid exit of coal fired power stations. There is also very strong non-legislated demand for renewable energy as large commercial and industrial energy users continue to seek long-term power purchase agreements to meet net zero and ESG targets.

Given all of these advantages the question must be asked, when does the public, either as energy consumers or taxpayers, cease underwriting the expansion of renewable energy? Assuming the 82% by 2030 target is reached, the renewable energy industry will simply be the energy industry. Is the expectation that public support is required to not only achieve 82% by 2030, but beyond this date? At what point does public support reduce and we revert to the energy market (in whatever future fit for purpose form it takes) being the primary driver of investment decisions?

¹ The Draft 2024 ISP increases backup gas power generation to 16GW by 2050, up from 10GW in the 2022 ISP. https://aemo.com.au/-/media/files/stakeholder_consultation/consultations/nem-consultations/2023/draft-2024-isp-consultation/draft-2024-isp.pdf?la=en

² 33,000,000 LRET certificates are required to be surrendered by liable entities annually. At an average certificate price of \$50 this equals an annual consumer funded subsidy of \$1.65 billion.

³ <https://www.csiro.au/en/research/technology-space/energy/energy-data-modelling/gencost>

⁴ The 2023 Draft GenCost report included these costs in the most recent analysis for the first time. Previously, transmission had been considered as a “sunk cost” and not included in the analysis.

While these questions are not addressed in this paper, this discussion will need to be had in the very near future to provide market bodies sufficient time to design appropriate future markets and to provide investors with a clear future investment pathway (including sunset dates for existing policy support).

These important questions aside, given the choice between a significant expansion of the existing LRET scheme, which is paid for by energy users, or a significant expansion of the CIS, which is supported by the federal treasury, the latter is the preferred option given the costs and risks associated with meeting 82% by 2030 are socialised across the tax base (the federal treasury), not energy users who are already feeling the strain of ever increasing energy bills.

If significant expansion of the LRET was to be the primary policy mechanism to support achievement of the 82% by 2030 target, we would anticipate that the amount of energy supported by the scheme would need to increase by approximately 200% above current levels and therefore drive a 200% increase in the subsidy cost to consumers. If this policy option was chosen, the consumer funded subsidy from LRET alone could be in the order of \$5 billion per annum. This would need to be collected from energy users every year up to at least 2040⁵. Along with significant other costs associated with reaching the 2030 target (transmission, storage, system strength, state-based schemes etc), this would put significant upwards pressure on consumer energy bills at a time when many are already struggling with current costs.

This is the primary reason why the EUAA supports the expanded CIS approach by the federal government⁶.

Policy support for deployment of renewable energy assets aside, significant other barriers remain that will hinder progress towards the 82% by 2030 target. Delays in planning for generation and transmission assets, community social licence, supply chain constraints, skilled labour shortages and escalating costs are all significant issues that could derail progress. Therefore, an expanded CIS is not a “silver bullet” (nor would an expanded LRET) and expectations of success may need to be tempered given there is only so much that governments alone can do.

SPECIFIC COMMENTS

CIS IMPLEMENTATION DESIGN

As far as we understand the CIS approach is not a CFD arrangement similar to the NSW Long Term Energy Service Agreements (LTESA). LTESA arrangement act as CFD option (with a strike price) for the project proponent whereas the CIS is a more arms-length approach that provides a cap and collar (which acts differently to a specific strike price). If the cap and collar are broad enough this should provide down-side risk management for debt while still allowing normal wholesale market functions to occur (such as PPA's).

All things being equal, we see that the CIS design has the potential to provide a “safe place” for investors to move forward with investment decisions and for market participants to transact.

⁵ This would result in approximately \$75 billion in additional consumer funded LRET subsidies provided to the renewable energy industry between 2025 and 2040. This is in addition to significant other transition costs such as transmission, storage, system strength and state-based schemes..

⁶ <https://euaa.com.au/euaa-welcomes-federal-government-expansion-of-capacity-investment-scheme/>

While always mindful of project proponents “double dipping”, from what we currently know of the two approaches (CIS and LTESA) they should be relatively complimentary and have the potential to significantly de-risk new renewable energy projects, which hopefully leads to lower contract prices for buyers.

The EUAA are generally supportive of the Design Framework Principles set out on Page 10 of the Design Paper.

- The EUAA supports the pursuit of the 82% by 2030 target, especially in the context of accelerated closure schedules of existing fossil fuel generators. Other serious impediments aside, the CIS should play a positive role in achieving the 2030 targets.
- We believe the CIS should support certainty for financiers but should not be seen by equity as a means to make excessive profit or to shift market participant risks onto taxpayers. Therefore, a focus on ensuring security of debt recovery is our preference.
- Government policy can have significant impacts on the efficient operation of wholesale electricity markets. For example, the current LRET and SRES legislation has had a significant impact on market dispatch and increased price volatility (i.e. negative pricing). The proposed CIS design, with its cap and collar arrangements, appears to maintain an “arms- length” relationship with the wholesale market which should not have the same impacts on wholesale markets as previous approaches. We remain conscious of any unintended consequences that may impact the ability of EUAA member companies from securing long-term PPA’s to meet net zero and ESG objectives and would welcome a more detailed discussion with the government on how this can be avoided.
- The EUAA support an orderly transition of our energy markets, including more clarity and transparency surrounding the exit of existing fossil fuel generators. In this context, there needs to be a degree of transparency regarding the Renewable Energy Transformation Agreements (RETA) entered into between the commonwealth and state jurisdictions. We support the RETA concept and the desire to leverage these arrangements to drive a more orderly transition of energy markets. Transparency around these arrangements will be important for both market participants and consumers as they seek to understand the direction and rate of change in each jurisdiction.

Other aspects of the CIS design that we support are:

- We support the “single tender” approach where project proponents are bidding for both NSW LTESA and CIS support as the two approaches appear sufficiently different so as to achieve different but complimentary outcomes.
- Bi-annual (6 monthly) CIS tenders seems reasonable. We would expect that market participants with large development portfolios would be bidding in multiple rounds of tenders over a number of years so transparency on the status of each project within the tender system will be important. This is especially so where the project proponent is seeking to negotiate a back-to-back arrangement (PPA) with a third party (i.e. retailer or large energy user). Uncertainty surrounding a projects CIS status creates unnecessary complications for all counterparties including the timeline for project delivery, risk allocation and price.
- Risks to contract market liquidity are important for all market participants, including large commercial and industrial customers. The design principles outlined under section 2.3 (page 14) of the design paper appear sufficient to remove the double liability issue raised by a number of stakeholders.
- As we have discussed earlier in this submission, we are hopeful that the design of the CIS will not act as an impediment to project proponents signing contracts with third parties such as retailers and energy users. The cap and collar (or the difference between them) will be one of the defining factors in this. We look

forward to further detailed discussion on this issue as it has been raised as a concern by a number of EUAA members.

In addition to the above, some members have raised the following issues associated with contracting that require further discussion/clarification:

- Eligible contracts >1year duration:
 - The definition of Net Revenue is a bit ambiguous as it mentions Eligible Wholesale Contracts, but then talks about all other sources of revenue including LGC's, capacity payments, etc. & all other revenue. Further clarity on what is and isn't an eligible contract would be helpful.
 - With a CIS in place, managing energy revenue with quarterly contracts could become a significant part of the contracting strategy and therefore could lead to adverse consequences under the CIS. It has been suggested that it should apply to all contracts.
- Contracting with Related Parties:
 - There could be unintended consequences when entities with a portfolio of assets bid into the CIS (such as confusion over what is bid into each tender round, entities using portfolio volume/dummy volume to block competitors from participating etc). Transparency and application of merit criteria will help to avoid these issues.
 - While there's a requirement for related party contracts to be at arm's length, there is no obligation to enter into a contract. This could allow the company not to contract the asset and trigger the floor/cap in low/high price years and undertake hedging at the portfolio level above the SPV level.
 - There could be many iterations for how this could play out, and it probably won't be possible to cover them all, but the issue deserves some more thought. It has been suggested that it should be mandatory for related parties to enter into an arms-length contract.

CISA PRODUCTS

- The basic CISA design information provided in the Design Paper seems logical and reasonable.
- We strongly support contracts containing milestone provisions requiring progress of project development.
- In addition to this we would like to see pre-bid conditions included up front such as bidding projects needing to demonstrate a degree of readiness and/or advancement (i.e. landholder options, initial grid access agreement, verification of the project proponent's ability to deliver, evidence of commercial negotiations with suppliers and off-takers etc). We must be satisfied that projects are "real", and the proponent is in a position to deliver. We need to avoid the situation where projects are bid into the CIS at unrealistically low levels which can then not be delivered as has been the case elsewhere⁷ or as a means of blocking competitors projects from advancing.
- Pre-conditions as described above may reduce the possibility of underbidding or "strategic" bidding, however we suggest that the prospect of penalties remain open for discussion.
- We support a maximum CISA term of 15 years as this is aligned with debt terms that we have observed. This would be consistent with the design principles of the CIS being to support certainty for financiers and

⁷ Early rounds of auctions in Brazil and Mexico revealed underbidding to be a problem for project delivery. <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/07/Executive-Summary-Renewable-Auction-Design-in-Theory-and-Practice-Lessons-from-the-Experiences-of-Brazil-and-Mexico.pdf> There is also anecdotal evidence to suggest that underbidding was used as a tactic to keep new entrant participants from entering the market.

not be seen by equity as a means to make excessive profit or to shift market participant risks onto taxpayers.

- We are supportive of the performance requirements of both Generation CISA and Clean Dispatch CISA.
- We can understand the principle of Clean Dispatch CISA requirement to bid at least 50% of its contracted capacity during an actual LoR3 event (i.e. the key aspect of the Clean Dispatch CISA is to be there when the market needs it). However, the potential operational (and financial) issues this may create are significant.
 - On one hand, while “holding back” 50% of contracted capacity could be seen as simply impacting the proponent’s ability to maximise revenue we would expect that given an actual LoR3 event has been declared that the wholesale price they would dispatch into would be at the MPC.
 - On the other hand, we would also assume that a Clean Dispatch CISA proponent would be readying themselves when AEMO declares LoR1 and LoR2 respectively (assuming that these declarations eventuated in actual LoR1 and LoR2 events, something that does not happen regularly). Holding back 50% of contracted capacity leading up to the period where an LoR1 or LoR2 event is forecast, and worse, during the LoR1 and LoR2 events, may actually contribute to the LoR3 event.
 - This goes well beyond creating a commercial issue for the proponent. It would most certainly impact wholesale prices (i.e. withdrawing dispatchable capacity from the market would drive up prices leading up to an LoR1) and ironically accelerate LoR3 conditions by holding back capacity leading up to and during the LoR1 and LoR2 events. This can only be a bad outcome for the market and stability of the NEM.
 - In addition, while holding back capacity, the proponent’s assets may not be located in the right geographic position to assist during the LoR3 due to network congestion or outages, however may be in the right place to prevent the LoR1 and LoR2 in the first place.
 - We feel that further detailed modelling and discussion is required to better understand this aspect of the CIS.
- We support the net revenue underwriting approach as once again it is an arms-length approach and should still facilitate relatively-normal wholesale market operation and bi-lateral transactions (i.e. PPA’s). We continue to engage with our member companies on their views as to the impact, if any, on their ability to engage in these bi-lateral contracts.
- There are two alternative approaches described in section 3.4 (page 22) of the Design Paper. Based on the information we have been presented with we do not see either of the two alternative approaches as being superior to the preferred option described in the Design Paper

TENDER DESIGN AND ASSESSMENT PROCESS

- As discussed earlier in this submission, the need to ensure that projects being bid into the CIS are real and capable of being delivered is critical to the integrity of the scheme. Therefore, we are supportive of the approach where bidding projects must have progressed beyond “early development” and suggest clear criteria is applied to this determination.
- As indicted earlier in this submission, we remain concerned that only short to medium term dispatchable resources will benefit from the CIS and that a policy gap exists associated with bringing long-term storage/dispatchable resources into the market. In particular the 16GW of gas plant that AEMO have identified in the Draft 2024 ISP.
- We are supportive of the intent outlined on pages 27 and 28 of the Design Paper (participation in other schemes) to avoid projects getting access to duplicate sources of government support. However, the list on Page 28 of the Design Paper is confusing given it identifies a number of government support mechanisms

that will not be considered revenue support, despite the fact that revenue support is still being provided (LRET certificates for example). As the CIS does not provide direct financial support for projects we can see how this could be complimentary and work to keep costs lower for consumers than they otherwise would have been. However further clarification on what is and what isn't considered a duplicate source of government support would be desirable.

- We are in general agreement with other aspects merit assessment and while supportive of local content we need to ensure that value for money for the Australian taxpayer is still paramount. Mitigating any concerns about the additional costs associated with the merit assessment regarding Australian supply chain, community and first nations (Page 30) is the fact that government is the underwriter of the CIS and therefore has an ability to make a “whole of government” decision about the costs and benefits of such decisions.

OTHER COMMENTS

Demand Response

We note in Table 4 (page 26) of the design paper that “virtual power plants, demand response or other aggregation and flexible loads may be eligible in future CIS tenders”. We strongly encourage that these consumer side resources be considered sooner rather than later.

Many EUAA members have significant safeguard liabilities. All are looking at deploying low/zero emissions technology over the coming decade to manage their Scope 1 liabilities. Many of these technologies (to the extent they are technically viable) are not yet commercially viable, even within the context of the safeguard mechanism. In many cases the price signal under the safeguard mechanism to deploy these technologies is significant enough so as to threaten the viability of the operation.

If customer side resources such as demand response, were to be included in the CIS then safeguard entities (along with many others) could design this flexibility into new plant design from the start (rather than retrofit which is disruptive and more expensive) allowing them to value stack both safeguard liability obligations/avoidance of carbon cost with an energy market revenue stream. This could work to encourage earlier deployment of low and zero technologies and accelerate the transition to net zero. It would also work to help maintain international competitiveness of Australia’s industrial base.

Deployment of technology that increases system strength

Much of the new generation technology that has been deployed over the last 15 years has slowly “chipped away” at system strength. Non-synchronous and inverter-based generation has played a significant role in creating a number of technical challenges.

Therefore, would encourage the deployment of technology that does not negatively impact system strength and/or require CIS participants to clearly demonstrate at the time of submitting their bid, how they plan to enhance system strength as a result of their investment.

For example, if the CIS is supporting the deployment of battery storage then consider a requirement they are grid forming, not grid following batteries.

Local Content

One of the key benefits of the 82% by 2030 target is the claimed job creation. For this job creation to be both meaningful and lasting then it would need to go beyond construction and installation jobs. We are also experiencing the impacts of international supply chain disruptions and acute skilled labour shortages that are slowing the growth rate of renewable energy and threatening our ability to reach the 82% by 2030 targets.

With this in mind, a number of EUAA members have expressed a desire for the CIS to be used to build local manufacturing capacity. We believe there is merit in this approach.

As stated previously in this submission, given the CIS is a taxpayer supported initiative there will be many opportunities for government to leverage the CIS to build strong local supply chain, taking a whole of economy approach to decisions.

We understand a number of our members will be making specific submissions regarding the opportunity for local content. As a principle the EUAA does not support individual projects so while we are generally supportive of principle of increasing local content we will leave it to those members to make their case.

Once again thank you for the opportunity to make this submission and we look forward to further engagement on the issues raised in the Design paper and the additional issues we have raised in the submission.

Regards



Andrew Richards
Chief Executive Officer