

25 July 2022

Anna Collyer
Chair
Energy Security Board
Level 15,
60 Castlereagh Street
SYDNEY NSW 2000

Lodgement: info@esb.org.au

ESB High level design paper: Capacity mechanism

Dear Ms Collyer,

Energy Networks Australia (ENA) appreciates the opportunity to respond to the Energy Security Board's (ESB) High level design consultation paper on the Capacity mechanism.

ENA is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

ENA recognises that the ESB is progressing toward a preferred design of a capacity mechanism that provides incentives to invest but also incentives to dispatch at times of system stress across the year. ENA agrees with the ESB that the design of a capacity mechanism should be straightforward to start with, and be able to be refined over time.

ENA note the considerable amount of work to develop detailed design by the end of the year. Whilst aiming for a nationally consistent and technology agnostic approach, the states still have considerable discretion on the technologies included and the level of out of market resources procured for the region.

It is crucial that agreed long term state energy policies and emissions trajectories are available before the first auction. ENA supports the ESB's need for Energy Ministers to advise on sectoral emissions reductions in the context of the move to net zero and the operationalisation of such guidance in the capacity market design.

ENA recommends:

- » The final detailed level design being properly costed and supported by an evidence-based cost benefit analysis to ensure the final model will benefit consumers;
- » The allocation of capacity payment costs to retailers. We agree with the disadvantages outlined for using the DNSPs/TNSPs as a cost pass through vehicle;
- » Retaining a simple, national approach to the treatment of interconnector capacity by progressing option 1 for the treatment of inter-regional transfers in the capacity requirements;
- » Incentivising generation to be available based on a forecast LOR2 should encourage plant to come back online, avoid actual LOR2's and LOR3's and reduce reliance on more costly RERT;

- » That AEMO have the discretion to vary from procuring to a fixed amount if the auction prices are too high. There should be appropriate checks and balances to ensure a balance of costs to consumers vs reliability; and
- » That the ESB consider the nature and strength of incentives for compliance by capacity providers.

ENA provides more detail below.

Proposed final detailed design should be costed and a demonstrated cost benefit analysis is required

In July 2022, the Australian Energy Market Operator (AEMO) said that its cost estimate for the NEM 2025 Reform Program is in the order of \$250 to \$330 million – excluding the capacity mechanism, congestion management mechanism and operating costs – with an additional \$9 to \$18 million for Data Strategy initiatives.¹ Importantly, the estimate also excludes implementation costs of other NEM participants such as retailers and networks.

This initiative needs to be properly costed and included in the NEM 2025 Reform Program project costs once the final detailed design is proposed. It is important that this initiative is supported by an evidence-based cost benefit analysis to ensure the final model will benefit consumers. ENA notes that AEMO can incrementally build on the ESOO and RRO capability already in place and also on the improved DR/DER data inputs to the ISP. ESB should also consider enabling transparency of the distributional aspects on consumers' bills.

Capacity mechanism payment cost recovery should be via the retailers

The high level design paper notes the pros and cons of capacity mechanism payments being allocated to TNSP/DNSPs or retailers. The ESB propose that the recovery of the costs of capacity should be via the retailers as this better aligns with settlement and prudential processes and provides an incentive for retailers to reduce their demand. ESB recognise that AEMO recovering costs via retailers and large users is a simpler approach and is well understood.

ESB recognise that any recovery via DNSPs/TNSPs would add to regulatory burden for no value, increases complexity and increases cashflow issues for AEMO. ENA agree with the disadvantages outlined for using the DNSPs/TNSPs as a cost pass through vehicle and strongly supports the allocation of capacity costs to retailers.

Retain a simple, national approach to the treatment of interconnector capacity

The ESB proposes two options regarding how resources in one region should be treated in a neighboring region;

- » Option 1 – recognise inter-regional transfers in the capacity requirement;
- » Option 2 – explicit procurement of inter-regional resources.

ENA recommend progressing option 1 rather than seeking a more complex solution at this time. The ESB suggested that the first auction is desirable in late 2024 with the mechanism starting in mid-2025. Option 1 is likely to be more practical and simpler to implement in the required timeframe, given the likely earlier timing of coal retirements and the challenges associated with implementing the mechanism. Opting for simplicity in the first instance does not preclude a move to a more complex solution if that is desirable

¹ AEMO, *Declared NEM Project – NEM 2025 Reform Program*, [Draft Report and Determination](#), July 2022, page 20.

later. If in future option 2 were to be adopted, we suggest this should occur in a manner that ensures that regulated transmission businesses are able to continue to operate their networks without significant new obligations or changes that impact the role and physical operation of interconnectors.

Seeking behavioral change by using forecast LOR2

It is vital that capacity providers meet the requirements of the capacity certificates, and this importance should be reflected in the nature of the underlying obligations and the compliance arrangements. ESB proposes that the performance obligation should be linked to availability across the year and bidding during times of system stress (LOR2 or 3) with weighted payments tied to both these obligations. To receive the final payment ESB proposes that capacity providers must bid available during actual LOR2 or LOR3 events.

ENA queries whether a better incentive is provided based on a forecast LOR2 versus an actual LOR2. Incentivising generation to be available based on a forecast lack of reserve should encourage plant to come back online, avoid actual LOR2's and LOR3's and reduce reliance on RERT. This approach should increase information for AEMO and reduce costs to consumers.

Centralised procurement should not be at any cost

ENA supports AEMO having the discretion to vary from procuring to a fixed amount if the auction prices are too high. The design should support appropriate checks and balances to ensure a balance of cost and reliability consistent with the Reliability Panel approach establishing the energy market settings.

ENA welcome the opportunity to work with the ESB on the development of intra-regional transmission capacity for the at risk periods at the appropriate time.

Incentives for capacity providers' performance

ENA agrees with the ESB that the performance obligation needs to drive operational incentives and support a culture of compliance for all capacity to work in the energy market. ENA encourages the ESB to examine the nature and strength of performance incentives on capacity providers, and to consider whether penalty payments will contribute to an efficient and appropriate allocation of risks between capacity providers and consumers.

Any questions on this response should be directed to Verity Watson, vwatson@energynetworks.com.au.

Yours sincerely,



Dominic Adams
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