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Lodged by email to: info@esb.org.au

### **Submission to the ESB Capacity mechanism High-level Design Paper**

#### **Who is ACCIONA?**

ACCIONA Energía is the largest 100% renewable energy company with no fossil legacy in the world. It has 11GW of renewable energy in 16 countries. With 30 years of experience, ACCIONA Energía offers a complete portfolio of tailor-made energy solutions for its corporate and institutional clients to meet their decarbonisation goals. ACCIONA is committed to the highest environmental, social, and corporate governance (ESG) standards. ACCIONA S.A., a leading global company in the provision of regenerative solutions for a decarbonized economy, is the reference shareholder of ACCIONA Energia.

ACCIONA has been operating in Australia since 2002, where it has successfully developed its renewable energy, water, and infrastructure businesses.

ACCIONA Energía develops, builds, and operates wind farms that produce clean energy for more than 285,000 Australian homes per year. It's installed capacity of 435 MW is distributed between Mt. Gellibrand (132 MW, VIC), Waubra (192 MW, VIC), Cathedral Rocks (64 MW, SA) and Gunning (46.5 MW, NSW). The company is currently commissioning a wind farm south of Mortlake (157.5 MW, VIC) and has recently commenced construction on the MacIntyre Wind Farm Precinct (1,026MW, QLD).

ACCIONA Energía has a strong development pipeline of over 3,000 MW of wind and solar projects to support Australia's transition to a low carbon energy supply over the coming years.

ACCIONA has also constructed major infrastructure projects such as the Legacy Way tunnel in Brisbane, a 41km bypass for the Toowoomba motorway, a desalination plant in Adelaide, the Mundaring water treatment plant east of Perth, and the Sydney Light Rail. ACCIONA is currently building two waste-to-energy plants in Western Australia among many other projects.

## **Introduction and summary of submission**

ACCIONA Energía welcomes the opportunity to participate in the ESB's ongoing consultation on a high-level design of a capacity mechanism. ACCIONA Energía has a breadth of experience operating across various markets, with over 11GW of power installed across 16 countries on five continents. We draw on learnings from across these jurisdictions to inform our position.

ACCIONA Energía understands that the ESB has been instructed to return to Energy Ministers with a draft capacity mechanism design by December 2022.

As outlined in a previous submission to the ESB on post 2025 market design, ACCIONA Energía does not agree that a capacity market is required nor that there is evidence of the need for large-scale reform. ACCIONA Energía strongly believes that if there are market failings requiring regulatory intervention, that targeted light-touch reform, preferably by utilising existing reliability tools, should be pursued.

To this end, ACCIONA Energía proposes that if a capacity mechanism is pursued, modifications to the existing Reliability and Emergency Reserve Trader (RERT) regime could be undertaken, rather than the large-scale reform proposed by the ESB.

## **The large-scale capacity mechanism as proposed will be costly and is unnecessary**

### **Large-scale reform as currently proposed is not needed**

The clear case for regulatory change and the issue sought to be addressed by the proposed capacity mechanism has not been clearly established.

Not only is the proposed large-scale reform not needed in the NEM, but it will be a costly endeavour that will increase costs to consumers. This alone is clearly at odds with the guiding principles for the reform agreed by Energy Ministers.

There are already several tools in place designed to deliver reliability in the NEM. These include the reliability standards and settings, the RERT and the Retailer Reliability Obligation. These offer an existing means to identify and address forecast reliability gaps.

Some have pointed to the recent period of administered price and market suspension as evidence of the need for market intervention. However, it should be noted that this event was not inherently a reliability event caused by a tight capacity balance. But rather was substantially due to the rational response by some generators to the current reliability settings – specifically generators limited generation offers to those that are economic at prices at or below the Market Price Cap (MPC) of \$300/MWh.

If anything, the recent events suggest that the reliability standards and settings need to be reviewed, including raising or indexing the MPC to remain consistent with prevailing costs of generation for marginal gas-fired generators.

## **Capacity mechanisms in other countries have not prevented load-shedding events**

Capacity mechanisms are not a panacea and it's important to learn the lessons from other jurisdictions. Jurisdictions with capacity mechanisms have experienced major load-shedding events despite these mechanisms being in place; examples include Texas and California.

Accurate forecasting of resource adequacy is a key requirement for effective capacity mechanisms. However, this is extremely difficult. There are many factors to consider, including the interaction between weather and generator availability/performance. How this is incorporated in forecasts may depend on which periods are defined as those reliability at-risk periods and therefore whether and how they contribute to de-rating factors.

A case in point is the Texas load-shedding event of February 2021. All generation fuel types except solar significantly underperformed relative to their expected aggregate capacity in the resource adequacy assessment for that period. Gas-fired generators delivered 37% less capacity than expected, and 21% less than the capacity expected in even the extreme scenario. Coal underperformed the extreme scenario by 28%, wind also delivered less than expected, but higher than in the extreme scenario. So, while the Texas market has a capacity mechanism, this did not enable it to avoid loss of power to 10 million people, some for up to several days.

This highlights the importance of forecasting in managing outcomes and suggests that building complex capacity mechanisms may not deliver better outcomes than a simple mechanism underpinned by robust modelling.

## **The proposed capacity mechanism risks significant wealth transfer from consumers to incumbents. Incentives should be restricted to reserves and new capacity.**

As currently proposed, the capacity mechanism would make all incumbent generators eligible for capacity payments. Paying for already existing capacity may result in substantial cost for little additional available capacity. These costs will be passed through to consumers and so could result in a significant wealth transfer from consumers to incumbent generators, with limited benefit.

Efficiency could be optimised by limiting incentives to out-of-market reserves (as per the existing RERT) and new capacity (not yet financially committed). Important for efficiency will be enabling the new capacity to also participate in the energy market rather than requiring it to act as a reserve and wait to be called.

### **Amending an existing mechanism may offer a lower regulatory cost approach**

Before looking to implement a large-scale reform which could be costly to develop and implement, the ESB should fully evaluate the potential to modify an existing mechanism such as the RERT to make it fit-for-purpose for the future. A lighter touch reform presents a significant opportunity to minimise the costs of policy development and ongoing regulatory/legislative burden. More so, ACCIONA Energía believes that with some modifications, the existing RERT could be consistent with Energy Ministers' guiding principles and objectives.

### **A modified RERT offers some significant advantages over a large-scale capacity mechanism**

The RERT already provides a mechanism to address reliability through contracting out-of-market reserves to respond to identified low reserve conditions or breaches of the reliability standard.

Under the existing RERT, AEMO already forecasts reliability, decides whether to contract, and centrally procures. The RERT could be modified to enable AEMO to contract new reserves or capacity to address reliability gaps further into the future than one year.

### **The RERT would need a few significant modifications**

AEMO is well placed to undertake an expansion of these activities. AEMO already has the flexibility in the RERT to negotiate/decide on the timing, capacity, and price of reserves. However, there are at least three elements of the current RERT that would need to be addressed:

1. Time horizons and categories for RERT contracting
2. New categories of RERT capacity eligible for spot market participation
3. Incorporating emission intensity limits within eligibility criteria for new RERT categories

The first issue is the timeframes in which AEMO can act on reliability gaps. Currently 'long-notice' situations of a reserve shortfall are defined as notice of between 10 weeks and 12 months. These short time horizons are not compatible with the procurement of new capacity due to the mismatch with multi-year development and delivery time frames for new projects. Longer time horizons of shortfall could however be considered (i.e. greater than one year notice and possibly up to four or five years). The longer periods could assist AEMO, possibly through various duration tranches, to take earlier action to secure investment in new capacity.

Under the RERT, AEMO monitors the Electricity Statement of Opportunities (ESOO) for forecast reliability issues within the one-year timeframe. However the ESOO forecasts reliability over a ten-year timeframe, and so already provides the means for AEMO to extend its monitoring timeframe.

The second issue is expanding AEMO's powers under the RERT to allow any new (not yet committed) capacity it may contract to also participate in the spot market. Specifically, such capacity would not act as out-of-market reserves. Allowing the contracted new capacity to participate in the spot market would optimise the economics of the additional capacity, facilitating a lower cost of delivered, dedicated capacity.

Under the current RERT rules, AEMO can conduct tenders for reserves to address 'long-notice' situations. Under a new 'very-long notice' category, AEMO could be given the power to facilitate competitive reverse auctions for new generation capacity. It would be open to AEMO to determine: 1) the required capacity, 2) the capacity contract tenor, 3) the structure of payments (i.e. upfront/on delivery) and 4) any technical requirements.

The third modification is to build in an emission intensity limitation, consistent with national policy objectives of net zero by 2050 and the Government's targeted 43% emission reductions by 2030, into the RERT eligibility and assessment criteria. This would be an important feature to ensure any new generation procured is consistent with the energy supply transition away from emission intensive sources. This objective should also be addressed more broadly through amendments to the National Electricity Objective.

The above changes are proposed as modifications and additions to, not replacements, for the current RERT. The existing shorter notice RERT timeframes for procurement of reserves should remain as an important back-stop for reliability challenges that emerge with less notice.

### **A RERT expansion addresses the key objectives**

Box 1 of the consultation paper outlines principles agreed by Energy Ministers, to guide the development of the capacity mechanism. How an expanded RERT would perform with regards to some of these key principles is discussed below.

Affordability and regulatory burden: Expanding the RERT to bring on new capacity would be more efficient relative to a full-scale capacity mechanism, while still meeting reliability objectives. Additional cost of capacity procurement would be limited by contracting only for new capacity. This would be expected to minimise overall costs to consumers and avoid a major wealth transfer from consumers to some incumbents. In addition, the mechanism being already legislated and functioning, would be much simpler and minimise the cost of policy development and ongoing regulatory burden, consistent with the principles agreed to by Energy Ministers.

Focused on reliability and encouraging timely replacement of existing capacity: An expanded RERT achieves this objective directly by contracting new capacity if required according to reliability forecasts. The amendments proposed to the existing RERT would facilitate competitive contracting of new capacity to bring investment forward.

Complement existing energy and contracts markets: Any modified RERT activities would incentivise only the additional capacity needed at the margin, and only if/when needed.

As a result it acts to bring forward new capacity on an as needs basis and would have minimal interference with the energy and contracts market.

Consistent with the NEO, but also continued emissions reduction of electricity supply: As the National Electricity Objective (NEO) does not reference emissions reduction, the existing RERT does not consider this. However, a key aspect of a modified RERT involves considering emissions intensity as an eligibility or assessment criterion thereby driving emission reductions. ACCIONA Energía fully supports amendments to the NEO to consider emissions intensity of generation and prioritise emission reduction objectives.

Enabling jurisdictions to opt in or out: While the RERT is managed by AEMO and doesn't specifically allow for jurisdictions to opt in and opt out, the RERT Guidelines require AEMO to consult with a representative of the jurisdiction in which AEMO is considering procuring reserves. As such, jurisdictional choice on participation is somewhat provided for.

### **Comments on key aspects of any capacity mechanism**

ACCIONA Energía does not support the implementation of a large-scale capacity reform as proposed in the consultation paper. However we have provided some limited comments on important key aspects of any reliability or capacity reform to be considered by the ESB.

#### **Participation of new and existing capacity**

If a capacity mechanism is ultimately implemented in the NEM, it should focus on attracting new capacity to the market – if needed – to facilitate the transition in energy supply characterised by greater levels of intermittent, zero emission generation. The focus of a capacity market should not be on delaying generator exit. Orderly exit of existing generators can be facilitated through other mechanisms, such as the notice of closure rules.

#### **Procuring capacity**

Contract lengths: The consultation paper raises the question of appropriate contract lengths for new capacity. Contract lengths that are too short could mean higher priced bids and may limit competition; long tenors risk inefficiently locking-in scheme costs for too long and less responsiveness to opportunities from emerging technologies. On balance, contract tenors of 5-10 years seem reasonable for new capacity.

Auction timing: New capacity will require longer lead times compared to existing generation, although it is technology dependent. Depending on a project's development status, and technology type, a period of between three and five years to reach commercial operation from auction award may be required. Timing of auction rounds must recognise these delivery periods.

#### **Centralised or decentralised forecasting and procurement**

AEMO already produces the annual ESOO which includes reliability forecasting, making it an appropriate forecasting body. Under the RERT, AEMO also has existing powers and

procurement experience to procuring capacity and is therefore well placed to undertake procurement. This would also mitigate potential market power concerns.

### **Penalties**

The setting of penalties for non-delivery of capacity/un-met obligations is an important consideration in incentivising the performance of contractual commitments. ACCIONA Energía is of the view that incentives for delivery are not sufficient. There should also be penalties for non-delivery of obligations, commensurate with the cost of non-delivery.

### **Comments on impact on the energy market and reliability settings**

The Consultation Paper canvasses the potential for changes to reliability settings – including a reduction of the MPC – if a capacity mechanism is introduced. ACCIONA Energía is opposed to this suggestion.

One of the stated principles in the initial request from Energy Ministers, was that a capacity mechanism should complement the existing markets. The MPC and its level underpins market price outcomes. Reducing the MPC would interfere in the energy market, and particularly impact the capital intensive, long term, private investment already made in generation assets. This would not be a tenable outcome for investors.

### **Conclusion**

ACCIONA Energía reiterates our view that the NEM is already well equipped with tools to ensure reliability of supply. While these tools, such as the RERT are fit-for-purpose for their original design, the RERT could be modified to support the future needs of the market if reliability challenges grow.

We would like to thank the ESB for the opportunity to participate in the Capacity Mechanism Design Paper consultation.

If you have any questions in relation to our submission or areas you would like to discuss further, please contact Melanie Sutton ([melanie.sutton@acciona.com](mailto:melanie.sutton@acciona.com)), Director of Markets and Policy.

Yours sincerely



Brett Wickham

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ACCIONA Energía