

22 July 2022

Ms Anna Collyer
Chair
Energy Security Board

By email: info@esb.org.au

Dear Ms Collyer,

CAPACITY MECHANISM HIGH-LEVEL DESIGN PAPER

Aurora Energy welcomes the opportunity to provide feedback on the high-level design of a capacity mechanism for the national electricity market (NEM) outlined by the Energy Security Board (ESB) in its Capacity Mechanism High-level Design Paper (the Paper) released on 22 June 2022.

A stand-alone Tasmanian retailer context

Aurora Energy is a customer-centric Tasmanian Government owned energy retailer providing energy services to the large majority of Tasmania's electricity customers. Aurora Energy's core focus is to deliver a reimagined experience for its customers and value for the broader Tasmanian community.

Whilst Aurora Energy retails to the majority of Tasmanian electricity customers, it remains a regulated stand-alone retailer with a significantly smaller customer base from which to manage costs compared to larger retailers with generation based assets, including those costs arising from market participation.

The Tasmanian energy system is unique compared to other NEM jurisdictions in that it is not currently capacity constrained and is supplied predominantly by dispatchable renewable hydro-electric generation. An important consideration in the Tasmanian context is that any increase in costs due to an emerging capacity constraint (for example as a result of the entry of significant new demand) should be based on a fair and equitable allocation to customers.

In relation to the ESB's proposed design, Aurora Energy raises the following points:

Eligibility

- Aurora Energy supports the ambition by Governments to transition Australia to a lower emissions energy sector. However, it also recognises the need to balance this ambition in the shorter term with maintaining a reliable energy system at a cost which provides commensurate benefit for consumers.

- In this context, Aurora Energy supports a “book build” approach to capacity procurement, whereby diversity in contracts are offered. This approach should seek to ensure that lowest cost capacity is secured for the varying capacity requirements (i.e. longer vs shorter capacity duration). This will also enable the strengths of different capacity technologies to be utilised.
- In implementing this approach, the aim should be to support low emissions technology - be it existing or new capacity. In this context, all existing renewable capacity should be eligible to participate (i.e. all existing hydro generation capacity).

Should the ESB consider it necessary that other thermal capacity is required to manage reliability and the cost outcomes for consumers associated with the NEM transition, Aurora Energy’s view is that the ESB should consider whether the contracting of thermal capacity could be better served outside of the proposed capacity mechanism, through a separate and more transitional capacity mechanism. This will ensure that the proposed capacity mechanism provides the appropriate longer term low emissions signals to the market and gives confidence to investors to invest in renewable capacity.

Forecasting and procurement

- Aurora Energy supports the proposed centralised approach with AEMO responsible for forecasting the capacity requirement, holding capacity auctions, awarding contracts and making payments to capacity providers. As discussed above, a book build approach to procuring capacity is supported.
- Aurora Energy acknowledges there is a need for flexibility in procurement to reflect the inherent uncertainty in AEMO forecasting future demand, particularly in the longer term. This is to mitigate the risk that AEMO inadvertently ‘over-insures’ the NEM by taking an excessively conservative approach to forecasting.
- Aurora Energy is of the view that retailers should not wear the burden if AEMO over-procures the capacity requirement, as these costs may be unnecessarily passed on to consumers for no commensurate benefit.
- Whilst the ESB is considering a hybrid approach in which retailers could play a role in forecasting and/or procuring capacity to prevent over-procurement, Aurora Energy notes that this approach has the potential to disadvantage stand-alone retailers without generation-backed assets. Should a retailer invest in capacity to reduce their wholesale market exposure, this capacity should be considered in the mechanism to either:
 - reduce the capacity requirement to be centrally procured by AEMO; or
 - reduce the retailers liability associated with ex post assessment of the centrally procured capacity costs that will be passed through.

Capacity providers’ obligation

- Aurora Energy considers that the cost of non-performance should be carefully considered.
- In particular, Aurora Energy suggests that there should be a penalty beyond non-payment if a capacity provider does not meet the performance obligation. For example, should a capacity provider not be available and RERT measures be enacted, consideration should

be given to making the capacity provider liable for RERT costs rather than retailers (and ultimately customers).

Such an approach is considered prudent to prevent arbitrage between the energy and capacity markets, which may result in additional costs to customers. For example, market outcomes on the energy side of the market may result in a generator who has a capacity mechanism contract dispatching and earning a higher commercial return from high spot prices in periods outside the capacity contract window. As a result of dispatching into these high prices they may not have availability to meet their requirements under their capacity contract. In this context, Aurora Energy also considers that the market price may need to be lowered to reduce arbitrage events and associated unintended consequences

Cost allocation

- Aurora Energy considers that capacity procurement costs should be allocated to all market participants, not just retailers.
- Aurora Energy supports the ESB giving consideration to how costs are allocated where the primary driver of the initiation of new capacity requirements is new demand. For example, should a new Hydrogen development in a state such as Tasmania (that is not currently capacity constrained) prompt the requirement for capacity to be procured, it seems inappropriate that all other market participants (and retail customers) in that jurisdiction are then liable for the costs of the new capacity required to support new demand. The unintended consequence of this is that new demand will not be incentivised to contract for capacity as they know there will be a mechanism that secures the necessary capacity and passes the costs onto other participants (they will only pay a proportion of the capacity costs). To mitigate this risk and impact on other participants and customers, the ESB should consider an approach whereby the participant responsible for the new demand that triggers a capacity requirement is liable for the full costs of that capacity to be procured rather than allocating to other market participants.
- Cost allocation should be considered in the context of the ESB's other work streams, particularly with regard to prudential and other risks that retailers may increasingly be expected to wear as market participant roles change across all post 2025 market design reforms. Interdependency modelling between the capacity mechanism and the ESB's other reform work streams is therefore important to assess whether some of the key assumptions about cost and other outcomes for customers will actually eventuate.
- Aurora Energy also suggests that the ESB's intent to undertake modelling to inform the preferred capacity mechanism design against a base case should consider costs and benefits at a jurisdictional level such that design reforms are only implemented where it is clear that the customer benefit outweighs the cost of implementation. This is an important consideration in the Tasmanian context so that any increased costs to Tasmanian customers are based on a fair and equitable allocation to those customers who benefit.

Aurora Energy appreciates the ESB's inclusive approach taken for consultation on the high level capacity mechanism design, and would welcome further opportunity to provide input ahead of the detailed design being released for consultation, particularly in relation to the impacts in Tasmania.

Should you have any questions regarding this submission, please contact Corinna Woolford, Strategic Policy Lead at corinna.woolford@auroraenergy.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read "Oliver Cousland". The signature is fluid and cursive, with a distinct loop at the end.

Oliver Cousland
Company Secretary/General Counsel