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Chair  
Energy Security Board

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## **Submission: The Australia Institute's Response to Capacity Mechanism Project High-level Design Paper**

Submitted by email [info@esb.org.au](mailto:info@esb.org.au)

Dear Ms Collyer,

The Australia Institute welcomes the opportunity to comment on the Energy Security Board's proposed capacity mechanism.

The proposed capacity mechanism is an inappropriate solution to challenges facing the National Electricity Market: rapidly scaling renewable energy and storage in the face of retiring coal generation. It would not have prevented the current energy crisis for occurring. The ESB has not offered a [problem definition](#) in the initiation paper to explain why a market mechanism of this kind is necessary, nor how it would complement the work of the states.

There is a risk that the proposed market would entrench coal generators, increase costs and fail to provide an appropriate price signal to bring online new storage and generation assets at the volume required to meet the federal government's target of 82% renewable energy by 2030.

The requirement that it should be "technology neutral" is misguided. A large part of the current energy crisis is the unreliability of coal power stations, which is expected to deteriorate further as they continue to age. Coal power stations should be excluded based on their lack of reliability.

Countries like Australia have been called on by the [UN Secretary General](#) and the [International Energy Agency](#) to retire coal generation by 2030 to deliver emissions reductions crucial for meeting [Paris Agreement goals](#). AEMO has acknowledged the unprecedented pace of energy transformation taking place, with coal generation retiring faster than anticipated. Retiring Australia's coal generation by 2030 is feasible, as outlined in AEMO's ISP Hydrogen Scenario.

The Australia Institute has been engaged throughout the ESB's Post-2025 redesign project, including participating in the ESB's expert stakeholder group advising on thermal retirements. We have previously [cautioned](#) against any proposal that could prolong the life of coal power stations, such as the physical retailer reliability obligation. Leading

innovative energy companies published an [open letter](#) to the ESB and state and federal energy ministers, co-ordinated by the Australia Institute, opposing interventions that would support coal generators and calling for solutions that support demand response, battery storage or pumped hydro.

The proposed capacity mechanism does not have [broad support](#). The proposed capacity market is a solution that has taken the ESB years to develop, yet details on how the market would operate remain high-level and without detail. It is unclear how the ESB could design and implement a capacity mechanism in the time necessary.

Policy solutions that can support improved energy security and reliability in the next 12 months, and solutions with broad-based support for the longer term, must be considered as a priority. A subsidy for storage projects that could be operational within 12 months could help mitigate the unprecedented conditions seen in the National Electricity Market to date this year.

The best way the ESB can meet Ministers' needs for a rapid measure to address the current energy crisis is to separate legacy and future assets, and deal with each expeditiously. The ESB should provide ministers with a simple and transparent mechanism to encourage new storage and generation and also a simple and transparent mechanism to schedule coal retirements. Trying to combine both mechanisms in a single market is complex, inefficient and lacks transparency.

Victoria has already started to solve the problem of coal retirement scheduling by signing a state agreement with Energy Australia to cover the Yallourn coal power station. The ESB has recommended states use contracting in the form of [Orderly Exit Management Contracts](#). This is a simple solution which states can implement immediately. The Australia Institute encourages the ESB and states to provide the market with maximum transparency around OEMC, to provide information to the market and encourage public accountability.

As Australia moves towards 100% VRE/DER, the wholesale spot market will lose utility. A new foundation market will be required in the 2030s, which values flexibility. Given that coal currently generates two thirds of NEM electricity and there is a large fleet of gas peaking generators available, there is no need for a radical flexibility redesign in 2022. The ESB should work towards the 'deep future' market design work, listening to stakeholders and working methodically through their issues and at the same time, accelerate the implementation of a simple capacity solution to address the current crisis and the challenges of the mid to late 2020s.

Longer term policy solutions should be supported by modelling, cost-benefit analysis and engage in broad, in-depth consultation to gain full industry support for a long term mechanism.

A Renewable Energy Storage Target (REST), as proposed by the [Victorian Energy Policy Centre](#), could utilise existing Renewable Energy Target legislation that has been proven as an effective policy mechanism. A REST could include household battery storage and electric vehicle-to-grid technology to support small-scale storage as complementary to large-scale storage projects. A REST would support net zero targets and renewable energy

goals in all states, with the potential for job creation and new local manufacturing opportunities. This could be framed as a 'new' capacity mechanism if eligibility is limited to new dispatchable storage and renewable generation that aligns with emissions reduction goals.

The Australia Institute supports Recommendation 4 of the ACCC's *Restoring electricity affordability and Australia's competitive advantage* Inquiry on retail electricity pricing:

*The Australian Government should operate a program under which it will enter into low fixed-price (for example, \$45–50/MWh) energy offtake agreements for the later years (say 6–15) of appropriate new generation projects which meet certain criteria. In doing so, project developers will be able to secure debt finance for projects where they do not have sufficient offtake commitments from C&I customers for later years of projects. This will encourage new entry, promote competition and to enable C&I customers to access low-cost new generation.*

This would be an efficient way of achieving the required capacity without cost to electricity customers or any risk of prolonging the life of coal or gas power stations.

Criteria for new generation projects could be developed by AEMO to ensure it met the requirements of firming capacity at the appropriate level of reliability, while aligning with emissions reduction objectives.

All policy options should be explored to support the delivery of 82% renewables by 2030 and any capacity mechanism developed must exclude coal, gas and other fossil fuel generation.

Regards,

The Australia Institute