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Orderly Exit Mechanism Framework - Consultation

AGL Energy (AGL) welcomes the opportunity to provide feedback on the proposed Orderly Exit Mechanism Framework (OEMF).

Proudly Australian for more than 186 years, AGL supplies around 4.3 million energy and telecommunications customer services. AGL is committed to providing our customers simple, fair, and accessible essential services as they decarbonise and electrify the way they live, work, and move.

AGL operates Australia's largest private electricity generation portfolio within the National Electricity Market (NEM), comprising coal and gas-fired generation, renewable energy sources such as wind, hydro and solar, batteries and other firming technology, and gas production and storage assets. We are building on our history as one of Australia's leading private investors in renewable energy to now lead the business of transition to a lower emissions, affordable and smart energy future in line with the goals of our Climate Transition Action Plan.

Overall comments

Ensuring an orderly exit of significant thermal generation assets is a key plank in the ongoing energy transition. The purpose of the OEMF – to maintain a reliable and secure electricity market – is something AGL strongly supports. Our Climate Transition Action Plan clearly sets out our intentions with regards to the closure of our major thermal generation sites and, importantly, the development of replacement capacity. AGL has a demonstrated strong track record of voluntarily providing the market with appropriate and transparent notice of closure of aging uneconomic thermal plant, investing in the transition and responsibly managing the closure of aging generators by working closely with market bodies and jurisdictions.

We note the consultation paper states the OEMF is intended to give government the tools necessary to manage the transition to renewables. However, there is a suite of government measures, including the Commonwealth Government's Capacity Investment Scheme (CIS), and other jurisdictional initiatives that governments are utilising to meet policy objectives. While the consultation paper acknowledges these other policies, AGL considers further assessment is needed to ensure that, collectively, the market is not being presented with mixed incentives. For example, analysis of the interaction between this framework and the CIS will be necessary to ensure they work together to strengthen our progress in the energy transition. There is a risk that CIS investments could put more pressure on existing thermal assets and conversely extensions to the life of thermal assets could increase the risk to new investment driving up these costs. Additionally, we note the development of a Value of Emissions Reduction will also play an important role in managing the transition to renewables, particularly around building new transmission infrastructure.

AGL has previously negotiated agreements with various jurisdictions relating to the operation of our generation assets, to provide certainty for both jurisdictions and AGL in relation to the future plans for those assets. This approach has allowed for a high degree of flexibility and discretion on the part of the jurisdiction and has allowed for agreements that suit the particular nature of both the assets and the needs of the jurisdiction.

We note that key stages of the proposed OEMF do not provide similar discretion and instead set out a highly prescriptive process. This raises serious questions as to whether the OEMF will be able to deliver the best outcomes. We note that a significant number of existing thermal assets are already subject to either a publicly announced jurisdictional Structured Transitional Agreement, or in the case of government owned



generation a jurisdictional plan for closure, so the OEMF will have a relatively limited application in terms of number of assets. It also seems from the consultation paper that there is an assumption around these assets being very similar (the only differentiation is by fuel type). However, by design these assets will have material impacts in their region and are highly diverse in terms of the specific operational, economic and technical factors that would both lead to an early closure as well as what agreement may best suit their ongoing support.

AGL notes that the proposed gap analysis proposed to be undertaken by AEMO (the System Needs Assessment) is a critical component of the OEMF. More detail is required on how the Systems Needs Assessment would be conducted. It would be useful to understand what types of recommendations could stem from AEMO's assessment, and how the assessment's findings would feed into the process of identifying proposed alternatives (to entering negotiations with a generator to reach a voluntary agreement, or the issuing a Notice for Mandatory Operation). As the gap analysis is such a vital component of this framework, it is essential that it be as robust and transparent as possible. This will help ensure that decisions made under the framework are based on accurate and up to date information and lead to the least cost and least distortionary options being actioned to alleviate any identified gaps.

The nature and timing of the gap identified will also be key to identifying viable alternatives to extending the specific generator under the OEMF. The existing 42-month notification of closure provides sufficient time to develop a variety of options that could address the gap quicker, and at a lower cost, than extending the operation of aging uneconomic thermal plant (particularly without free agreement of the owner if a Notice of Mandatory Operation is used). There are a suite of alternative options that could appropriately respond to a gap. These options extend beyond the build of new generating capacity, and could include demand response, improvements to the reliability of other plants, reserves, forecasting improvements, network augmentation and orchestrated batteries.

In the event a Notice for Mandatory Operation is implemented in response to a gap where the primary concern is reliability, then the performance obligations and commercial cost recovery mechanism should only relate to the operation of the OEM Generator in those times that the gap exists. A mechanism that is not targeted may cause significant distortions to the spot market, unpredictable operational outcomes, deter investment in existing and in new generation essential to maintain reliability and close the gap. If these risks materialise, then arrangements similar to intervention pricing should be considered to mitigate these impacts.

Finally, we have several concerns about the impact the proposed commercial cost recovery component of the scheme may have on assets subject to a Notice of Mandatory Operation, as well as the operation of the NEM, market participants, and new entrants. Some of these concerns relate to the OEMF being proposed to utilise only one specific commercial mechanism, that is financial contracts. Additionally, we have concerns that some drivers of closure might sit outside the scope of the commercial mechanism, resulting in OEM Generators not receiving sufficient compensation. This issue arises due to the limited discretion to design an effective commercial mechanism that suits a particular generator, and the gap is it required to remedy. This could include issues around environmental licensing or commitments made to community or investor groups around climate transition planning. Some of these issues are unlikely to be adequately addressed through a standardised compensation framework.

We note the AEMC is currently conducting a review into electricity compensation frameworks.¹ AGL has made a submission to this review. We consider that, in principle, we should work towards achieving consistency across compensation frameworks where appropriate. Our submission to the AEMC's review highlights some important principles that AGL considers are equally relevant to the cost recovery process under the OEMF.

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<https://www.aemc.gov.au/market-reviews-advice/review-electricity-compensation-frameworks>



We provide more detail on our general concerns below and have endeavoured to answer the questions posed in the consultation paper in the Appendix to this submission. Given the complexity of the subject matter, we suggest further one-on-one engagement with potentially impacted generators would be required to minimise the risk of unintended and disastrous consequences of the framework.

Staging and Prescribed Information

We consider that the proposed staging of the OEMF can be significantly improved. Our first main concern is that under the current design, participants would be required to provide detailed and highly sensitive commercial information to numerous external parties before a System Needs Assessment – to determine the impact of the early closure of the OEM Generating Unit on the reliability and security of the electricity system – has been conducted. This places a significant and avoidable administrative and regulatory burden on participants at a time when it is not certain the information is required.

The consultation paper states OEM Generators will be required to provide this information in order to facilitate later processes including the possible negotiation of a voluntary agreement and estimating the possible cost of a Notice for Mandatory Operation. If this information is necessary to facilitate later processes, then we would strongly suggest OEM Generators be required to provide information later in the process when there is more certainty that it will be needed.

Also, the broad requirements around information provision creates a risk that commercially sensitive information may not be used for its intended purpose. For example, the consultation paper states that OEM Generators would be required to provide details of existing contractual obligations. AGL supports implementing strong protections around the provision, access, use, and protection of commercially sensitive information provided under the OEMF.

Further, the information requirements in the draft OEMF are highly prescriptive and inflexible. Given the array of scenarios that could cause a generator to decide to bring forward a closure date, and the impact the early closure could have on the market, the framework should allow for flexibility around what information is provided, and to whom. In general, we consider that requirements around the provision of Prescribed Information would be significantly improved if they were guided by an overarching principle that any information required must be relevant to the precise scenario being faced – namely, the issues identified following AEMO's System Needs Assessment. Further, the framework should be designed to avoid duplication and make use of information already available. This would be consistent with instructions previously provided by the Commonwealth Government.²

We are concerned that the current drafting suggests that the Notice of Mandatory Operation may not be intended to be a measure of last resort. This could be amended by providing further detail on the requirements of generators and jurisdictions when negotiating voluntary agreements. For example, an obligation for both parties to negotiate in good faith could result in more voluntary agreements being struck, and for the Notice of Mandatory Operation to function truly as a measure of last resort.

AGL considers further clarity should be provided on how the OEMF would apply when a generator that has entered into an agreement with a jurisdiction (including agreements entered into prior to the OEMF being implemented or separate to the agreements contemplated under the OEMF) announces its intention to close the generator earlier than expected.

There may be benefit in giving further thought to how the governance arrangements of the OEMF could be strengthened. As some jurisdictions have interests in assets that could be affected by decisions made under the OEMF, it may be appropriate that decision making responsibilities do not sit solely with a Jurisdiction's

² For example, the Commonwealth Government specifically instructed the ACCC to avoid duplication and make use of publicly available information when it extended its Gas Inquiry.



Minister. For example, involving market bodies could help ensure that decisions are made to best ensure the orderly exit of thermal generation in a way that does not adversely impact on reliability and system security needs, and at the least cost.

Gap Assessment

We note that the consultation refers to AEMO utilising a similar methodology to the Electricity Statement of Opportunities (ESOO) in performing the System Needs Assessment. Our view is that the process to identify and quantify the precise gap that would occur under an early closure scenario is fundamental to the correct operation of the OEMF.

Relevantly, in preparing the ESOO, AEMO conducts an assessment to determine when production unit or demand side participation capacity or augmentation of the power system is required to meet the reliability standard. The reliability standard reflects a maximum expected unserved energy (USE) in a region exceeding a set proportion of total energy demand in that region for a given financial year.

Under the Retailer Reliability Obligation (RRO), AEMO is also required to publish in the ESOO a five-year reliability forecast and five-year indicative reliability forecast (covering years 6-10 in the ESOO horizon) for each NEM region. The approach to calculating the expected USE is the same for both the ESOO and RRO and is set out in the Reliability Standard Implementation Guidelines (RSIG).

While AGL considers that a System Needs Assessment carried out in accordance with the RSIG would involve many of the factors critical to assessing the impact of the early retirement of a generator, it would not consider all the relevant factors. In particular, AGL recommends the System Needs Assessment should also require consideration of the impact on system security and the provision and need for ancillary services. Further, the definition of USE is limited to individual NEM regions. Given the early exit of a generator would have NEM-wide implications, AGL strongly suggests that the System Needs Assessment not be limited to the NEM region where the OEM Generator is located, and instead consider the broader implications.

AGL is committed to supporting decision makers undertake this complex work, and in principle supports the inclusion of broader consultation as part of this process.

Commercial Component

Under the proposed Notice of Mandatory Operation (NMO), the AER will be asked to perform a complex assessment of the potential costs and risks associated with operating an asset that would otherwise have closed for a variety of reasons. The proposed form of regulated outcome seems to draw a lot of parallels from the AER's experience in monopoly regulation of network assets. We consider that the approach required to determine a regulated revenue outcome for an ageing thermal generator is vastly different. We understand that the proposed financial contract framework to determine the commercial outcomes for such an asset provides a clear and relatively consistent process. However, as we have emphasised in this submission, a rigid and predetermined commercial mechanism may be incapable of delivering appropriate compensation in all circumstances while minimising negative interactions with the market or other frameworks.

The consultation paper is relatively silent with regards to assessment of how the OEMF could impact necessary investment signals for the new build required under the energy transition. We consider that there are many potential scenarios whereby a financial contract type commercial component could significantly impact the investment case for new generation. Additionally, this could be further exacerbated by the outcomes of one NMO leading to the accelerated closure of other generation that is not covered by any support agreement and is relying on market outcomes to remain open.

In appendix 1 we provide some additional comments on the commercial component, particularly around the difficulty in determining the total quantum of costs that a generator subject to an NMO may face.



We thank the department for the opportunity to make this submission and if you have any follow up question please contact Chris Streets, Senior Manager Policy and Regulation on +61 4109 533 584 or at cstreets@agl.com.au

Yours sincerely,

Ralph Griffiths

General Manager Policy and Markets Regulation



Appendix 1

1. *Is this mothballing precondition appropriate?*

We do not support the inclusion of scenarios relating to mothballing of plant in this framework. The particular issues that lead to mothballing of plant are likely to be quite different, and it would not be appropriate to view them through the same prism as an end-of-plant-life decision. We are particularly concerned with any restrictions on ways to enable flexible operation of plant in line with commercial drivers, including seasonal running or preservation of an asset during periods of extended low demand.

2. *Do you have a view on the timings in the mothballing precondition?*

As above we do not support inclusion of mothballing in the OEMF

3. *Are there concerns with requiring the Prescribed Information to be provided when the OEM Generator notifies of a change to its closure date (or applies to the AER for an exemption from the notice of closure requirements)? If yes, please provide details.*

We consider it to be overly burdensome and potentially distortionary to the negotiation framework to provide the broad suite of prescribed information at the very outset of the OEMF. We note and support the proposed staging and information requirements as set out in the submission from the Australian Energy Council.

This proposal properly stages the information requirements to the times that they are needed by each party, reducing the burden on a generator particularly in instances that either a gap is not identified, or an alternate solution is preferred.

4. *Noting that generators may operate under complex corporate structures, what are the best means for addressing related entities that provide services that are required for the operation of the System Significant Generator?*

We consider that this is one of the areas of the OEMF that cannot be easily codified, and should be dealt with on a case-by-case basis due to the differences across potentially impacted generators.

5. *Are there other specific insurances that should be maintained?*

As with our prior comments, there may be insurances specific to the plant and required operation that may be appropriate. We would recommend flexibility in determining these requirements.

6. *What information should be published to the market regarding AER decisions?*

We do not have any specific concerns with regards to the proposed content of the NMO under section 10.2 of the consultation paper.

7. *What are your views on the appropriateness of the proposed commercial component outlined in section 10.10?*

We have raised our concerns with regards to the appropriateness of the commercial component in our submission above. We would reiterate our position that a less prescriptive methodology may be more fit for purpose and could be better matched to the services being procured under the OEMF.

If this methodology is utilised under the finalised OEMF, then it is of utmost importance that the wide array of potential costs (both direct and indirect) should be compensated and risks need to be appropriately assumed by the jurisdiction that is requiring the generator to remain open.



8. *Is an alternative commercial component approach preferred and, if so, why?*

We would support a more flexible approach that seeks to match the form of commercial arrangement to the precise role that the generator is being required to perform. This approach should ensure that the generator operation is fully compensated, contains appropriate terms relating to the risk of operating potentially unreliable plant at end of technical lives and minimises the distortionary impact that the generators operation would have.

9. *Are there other key issues that need to be considered as part of the commercial component?*

Under any approach to determine the commercial component of an NMO we would suggest that in addition to the operating costs identified in the consultation paper, there are a suite of other costs that would be potentially suffered by the generator subject to such an order. The paper fundamentally looks at more traditional economic and technical drivers behind closure but we would contend many other factors are included and could drive additional costs were that generator forced to remain open. These could include:

- Access to capital – institutional investors are increasingly aligning lending practices to climate aligned targets.
- Social license – many of these significant generators are also significant employers and economic centres for regional communities. Continued uncertainty around closure dates could cause harm and distress to those communities.
- Reputational damage – this is a very broad category, however as has been the case in other instances, ongoing uncertainty and politicisation of decisions around closure have demonstrated the ability to cause serious reputational damage to a business that could drive significant yet unknowable cost impacts.
- Lost opportunity for portfolio based on under-utilisation of other assets – given many of the assets likely to be captured under the OEMF are operated as part of a portfolio, there needs to be consideration on any flow on impacts across the portfolio through requiring an asset to remain open. In some cases an NMO could cause flow on impacts to other significant assets within a single portfolio as well as across competitors.

10. *Should the financial model include an additional incentive component, even if small, so that the generator has some incentive to contain costs?*

We do not consider that this additional complication would add much benefit to the arrangement, however if an alternative commercial component were to be allowed to be agreed upon under the OEMF then an incentive component may be appropriate. Under the proposed commercial component we do not consider it to be appropriate.

11. *How should services provided by related entities be treated*

This is highly complex and should be assessed in each scenario.

12. *Should the AER have the ability to "look through" the billing arrangements of services provided by related entities to see the actual costs without mark ups?*

This decision could be worked through as part of a more flexible approach to the commercial component. In some circumstances and with some entities, this may be appropriate. However, it may be unnecessary under others.

14. *Should there be a 'true-up' settlement in the event that actual capital expenditure and FOM expenses (fixed costs in the case of gas fired generators) differ materially from the ex-ante determination on which payments to the OEM Generator were based?*

We would support a mechanism to ensure ongoing assessment of potential under-recovery on costs associated with continued operation of a generator.



16. What do you think of using the proposed new transmission cost recovery mechanism compared to the existing distribution network cost recovery mechanism contained in the national electricity rules (“Jurisdictional Scheme”)?

We do not have any concerns with the proposed mechanism,

18. Would the shielded loss and gain option be a more suitable commercial component approach for the Notice for Mandatory Operation compared to the financial swap approach detailed in the body of the consultation paper?

As stated in our cover submission, we would support flexibility as to the type of commercial component that was used in order to minimise market distortions and investment incentives, be appropriately balanced against the type of gap being alleviated, and avoid placing undue risk on assets that have reached their technical end of life.

We do consider that in some circumstances the shielded loss and gain option could be a more suitable mechanism for assets such as gas peaking plant.