



The Office of Energy and Climate Change
NSW Department of Climate Change, Energy, the
Environment and Water

By email to energy.consult@dpie.nsw.gov.au

01 February 2024

To whom it may concern,

Orderly Exit Management Framework – Consultation Paper

ENGIE Australia & New Zealand (ENGIE) appreciates the opportunity to respond to the New South Wales Office of Energy and Climate Change (“the OECC”) in response to the Consultation Paper on an Orderly Exit Management Framework (“the Paper”).

The ENGIE Group is a global energy operator in the businesses of electricity, natural gas, renewable energy development, and energy services. In Australia, ENGIE operates an asset fleet which includes renewables, gas-powered generation, diesel peakers, and battery energy storage systems. ENGIE also owns Simply Energy which provides electricity and gas to retail customers across Victoria, South Australia, New South Wales, Queensland, and Western Australia.

General comments

ENGIE’s interest in the Orderly Exit Management Framework (OEMF) is threefold.

First, as a former owner and operator of coal plants in Victoria, and a current operator of gas-powered generation and diesel peakers in South Australia, we have some insight into the commercial challenges of running large thermal plants as they reach the end of their useful economic lives.

Second, as an active developer of new generation in New South Wales (such as the recently approved Hills of Gold wind farm) and elsewhere in the NEM, it is important to understand the market impacts of a process that may change the retirement date of a large thermal plant.

Finally, as a retailer, we are conscious that many of our customers are dealing with cost of living pressures and it’s critical that they get value for money for any costs added to bills as a result of the OEMF in exchange for clear security of supply benefits. To this end, the proposal to spread OEMF costs across all users of electricity via TNSP charges is equitable.

Rationale for entering into an arrangement

The Paper is very much driven by the circumstance where a generator seeks to leave the market and the State does not believe that exit at the designated time is possible without compromising reliability and

security. ENGIE appreciates that this view of the world may currently loom large in public commentary and government thought, but it is unlikely to be the only situation in which a large generator's exit from the market could be better managed by government. ENGIE believes two other, and potentially more significant circumstances need to be considered by the OECC should the policy espoused in the Paper be capable of adoption and use across the NEM.

ENGIE suggests the two additional scenarios are: (1) sudden retirement as a consequence of plant inability to continue operations, likely due to declining investment in maintenance or simply early end of asset life (i.e. it can become hard to replace some parts on older plant); and (2) plant continuing to operate until its declared closure date, but the State determining that the ability for the plant to leave at the designated time is not viable as an insufficient number of new assets have been built that can replace the closing assets capacity.

By way of example, the Australia Energy Market Operator's (AEMO) Draft 2024 Integrated System Plan predicts noted additional investment in gas assets; however, ENGIE contends there is no viable business case to invest in gas assets to the extent predicted by AEMO. As such, governments may be better placed ensuring that existing gas assets, and by extension other technologies, remain in the market beyond their currently nominated closure dates.

Additionally, entering into such agreements well in advance of proposed closures, with conditions that guarantee the required maintenance and operation to be able to extend asset life beyond current nominated closure dates (if so warranted), and an ability for the State to cancel the agreement with agreed notice, can be negotiated in an environment devoid of brinkmanship that may be associated with impending closures.

ENGIE appreciates that such an idea may not be well received by some policy makers; however, both the Finkel Review and the previously proposed capacity mechanism developed by the Energy Security Board, before its termination, recognised that many technologies require capacity support to remain in the market during the energy transition. In fact, the Capacity Investment Scheme (CIS) recognises this fact, through the use of floor contracts, but does so for renewable and storage assets only. A contract arrangement similar to the CIS, although many alternatives could be advanced, would be one way of locking in assets which are required to operate for an extended period of time to support the energy transition.

The above approach does not prohibit the negotiation of agreements voluntary closer to closure, but accepts that in some circumstances, negotiations are better to occur now to lock in clear closure dates for all parties, improve guaranteed asset performance, and provide greatest certainty to investors in new plant and clear benefits to consumers.

Disruptions to financial markets and investors, and consumer certainty

The approach proposed by ENGIE above, also is likely to minimise impacts on financial markets and investors. The problem with the approach in the Paper is it gives rise to significant uncertainty and a likelihood in some instances that a decision on asset life continuation may not be made until very close to intended closure. This will impact financial markets and investors greatly because the decision will directly

impact the outturn of the spot market, and therefore the contract market, and also investor returns in any given year.

While it would be a bigger initial task to undertake System Needs Assessments in the near term, and enter into negotiations with all relevant generators, such an approach would provide better long-term planning for all participants and the market.

Consumer benefits would be increased as the further out governments seek to negotiate with a significant generator, the greater the risk that that generator will be replaced by other market investments and thus the significant generator has a heightened incentive to negotiate an outcome. This means the State can seek viable alternatives and extract a lower price for a higher degree of consumer benefit under a longer duration contract a decade out from closure.

Such an approach would also provide for better outcomes for consumers especially if all agreements contained a cancellation period whereby the State can cancel the agreement when it became clear new investments would arrive in time to fill the gap.

Mandatory requirements and performance requirements may be unrealistic

Based on ENGIE's experience retiring assets in Australia, and elsewhere, it is clear governments have an unrealistic expectation of their ability to direct assets to continue to operate under mandatory arrangements. While policy makers may have specific existing assets in mind where this may be possible, it is unlikely to always be possible in 2030, 2035, or 2040 and beyond.

If ENGIE can use its experience with Hazelwood, once an asset reaches end of life, no number of directions or powers the State may award itself, will be able to overcome the physical realities of a failing plant with limited reliability. It is for this reason also that ENGIE proposes a framework which proactively identifies all significant plant and works to ensure those plant are able to extend their operational lives beyond their current closure dates, if required.

ENGIE notes a growing theme among policy makers to attempt to mix financial contracts with physical performance and attempts to punish non-performance which demonstrates a lack of familiarity with market incentives and asset performance. Leaving aside, non-performance already costs generators and therefore should not be subject to further penalties, it is not appropriate to have high expectations of asset physical performance where that highly complex asset is close to retirement. Even more so where the agreement is not voluntary, but imposed, without consent.

If government wants to bind an asset to some form of physical availability than asset maintenance will need to be performed to the highest standards throughout the asset's life. Where maintenance has declined due to planned closure, it is not always possible to return that asset to its former condition. For some older plant it may be impossible under any circumstance, but either way, this is something governments are better off understanding now than at some random point in the future when the concern is raised.

A parallel could be drawn with network businesses. Those businesses are required to operate and maintain their assets over the agreed life to minimise outages and the consequent impacts on consumers in terms of price and reliability. In exchange, those assets are able to secure a guaranteed return and recover efficient

maintenance costs. They are not subject to tier 1 penalties for non-performance when such an outage occurs.

Likewise, tier 1 penalties should not be imposed on generators, and while regulated returns are not appropriate per se, the use of a mechanism like the Capacity Investment Scheme or a long-term bespoke contract linked to performance in exchange for agreed terms may be. But like network businesses, the contract in place must cover all reasonable costs and not leave the generator exposed to costs it can't manage when it is being required to operate beyond the date which it would voluntarily do so commercially.

Finally, all parties need to be conscious that is not possible to operate plant that is unprofitable (including via penalties), and that continuing to operate such an asset would result in insolvency, and could have implications for relevant Directors.

Mothballing

Mothballing is a different situation from closure and may occur well before end of life if commercial conditions mean the generator is unlikely to be able to make a return over an extended period (and more so with the 42 month closure rule). Mothballed plant can be brought back to service as market conditions improve; however, the duration required to return to service is likely to represent the owner's preferences not the governments. For example, the duration of time required to return a unit to service is likely to be directly linked to ongoing maintenance. A longer recall time is likely to mean lower levels of expenditure and thus may be favoured by the owner.

ENGIE recommends that mothballed plant are not covered by the OEMF unless government wants to support a shorter recall time than the owner proposes, in which case an agreement would need to be struck to cover the additional costs required for quicker recall, or some other arrangement.

Prescribed information

Information asymmetries are an inherent part of voluntary negotiations, and under voluntary arrangements, financial information should not be part of the prescribed Information, which should be restricted to any technical information required to understand/confirm the specification of the services being offered.

Under mandatory arrangements, if the Australian Energy Regulator is going to be tasked with determining the allowed revenue (whether in an NSP-style revenue control or a financial contract as envisaged in the Paper), then it may be best left to an Australian Energy Regulator Notice process to collect the necessary financial information.

Related entities

Concerns about related entities is essentially a legal question that simply requires the government's lawyers to phrase the terms of any contract with the significant generator, such that the existence of related entities does not undermine the intent of the contract. The significant generator will need to procure services from other parties in order to meet the terms of the contract in any case and whether they are related or not should not make any difference.

Insurance requirements

The whole concept of an OEMF is essentially a form of insurance entered into on behalf of consumers. The contract itself will presumably be worded in such a way as to provide a strong incentive on the generators to deliver the services to the best of their ability – even if it is limited to a “best endeavours” approach as recommended for a mandatory arrangement. This will still include an incentive to enter into the usual insurance arrangements that a commercial entity would.

Should government consider that there is value to consumers to having additional insurances it can of course insist on these as part of the contract, noting that either way the price of the contract will need to increase accordingly.

Shielded loss and gain option

The shielded loss and gain option is closer to the regulated revenue model that may be better suited for mandatory arrangements than the financial swap.

Either way, there is a knock-on impact on the Retailer Reliability Obligation. Since the OEMF is likely to be in part be used to meet reliability, and since retailers are obliged to enter into contracts to cover their share of overall peak demand, the generators contribution to reliability needs to be accounted for in the RRO process. Either retailers will need access to RRO contracts, or the significant generators contribution must be deducted from the regional aggregate RRO requirement (which would presumably require an amendment to the enabling laws or regulations).

In the former case, if the OEMF arrangements utilised financial contracts, then these could be sold into the market (noting that the government may take a loss as the necessary strike price to keep the significant generator whole may exceed market prices), but under a regulated or shielded loss or gain, there may be limited incentive for the generator to offer contracts into the market. So, some form of obligation or incentive to do so may be required.

Should you have any queries in relation to this submission please do not hesitate to contact me on, telephone, 0477 299 827.

Yours sincerely,



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Compliance, and Sustainability