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CLEAN ENERGY COUNCIL

9 November 2018

Mr Rob Heferen
Deputy Secretary, Energy
Department of the Environment and Energy
GPO Box 787
Canberra ACT 2601

Lodged by e-mail: UnderwritingNewGeneration@environment.gov.au

Dear Mr Heferen,

UNDERWRITING NEW GENERATION INVESTMENTS – CONSULTATION PAPER

The Clean Energy Council (CEC) is the peak body for the clean energy industry in Australia. We represent and work with hundreds of leading businesses operating in solar, wind, hydro, bioenergy, marine and geothermal energy, energy storage and energy efficiency along with more than 5,600 solar installers. We are committed to accelerating the transformation of Australia's energy system to one that is smarter and cleaner.

The CEC welcomes the opportunity to respond to the Department of the Environment and Energy's Underwriting New Generation Investments Consultation Paper. The Australian energy system is undergoing a significant transformation that requires substantial new investment in generation. The clean energy industry has long advocated that the key precursor to timely private investment in new generation to support this transformation is an enduring national energy policy.

The CEC considers the government program outlined in the Consultation Paper is insufficient to support the current transformation and could lead to perverse, unintended consequences. The clean energy industry is keen to see more contracting to underwrite new low-cost generation projects. Given this, we support in-principle the intention of the Australian Competition and Consumer Commission's (ACCC's) original recommendation to address some of the challenges with project financing in order that more customers can access the benefits of low-cost generation. However, we strongly suggest that any intervention in the market by government to facilitate new investment needs very careful consideration to ensure it does not have the opposite effect of dampening innovation and undermining investor confidence.

The proposed government program is a high-risk strategy that creates a market distortion that could have the opposite outcome to the one intended. The National Electricity Market (NEM) is one of the most liberalised energy markets in the world. Throughout its history when there has been political and policy stability, the NEM has been successful at attracting new investment in generation capacity which, as an energy-only market, is incentivised by higher price periods. This does not represent market failure. On the contrary, it shows that the market is working. The current boom in investment in wind and solar power, similar to the previous boom in gas-fired generation in the 2000s, is as a direct result of the high wholesale market prices seen in recent years. The entry of these new renewable generators is already bringing down wholesale

prices, which is the expected result in the energy-only market design. As a capital-intensive sector with long lead times for obtaining planning approvals and for building projects, the energy sector has always had a classic 'lumpy' investment cycle. Further, energy sector projects have long asset lives of 30 or more years. These two features strongly require that the market is allowed to work without fear of rushed government intervention. Any proposed intervention must be thoroughly assessed to ensure it will not distort natural market forces and operations.

The CEC is concerned that as the program is developed and while it is in operation this could lead to an investment pause as the market awaits the program's outcomes. As such, we are concerned that the proposed program will not deliver on the current market challenges of securing the energy system, ensuring affordable energy supply to consumers and lowering emissions to meet Australia's international commitments. If the program is to proceed, it is of the utmost importance that is carefully designed so to avoid such an outcome.

A stable and integrated climate policy is still critical

The Consultation Paper builds on the ACCC's Retail Electricity Pricing Inquiry Final Report recommendation that the government should operate an offtake program for the later years of appropriate new generation projects (recommendation 4). In the commentary to the following recommendation in its report (recommendation 5), the ACCC noted that it:

> "considers it critical for there to be a stable energy policy in Australia which incorporates the need for Australia to meet its climate policy obligations but at the same time does not distort the way in which new generation capacity enters the market."[1]

The clean energy industry strongly calls on the government to focus on developing an integrated climate and energy policy that delivers a stable policy environment and investment certainty as a priority. A lack of policy certainty is already being reflected in higher prices as forward energy prices have increased substantially since the government announced it would not proceed with the National Energy Guarantee (NEG). Only through long-term policy certainty can industry look to address the prevailing market challenges around reliability, affordability and emissions.

In relation to emissions reduction objectives, the CEC notes that the Consultation Paper states a project eligibility criterion that the project would be unlikely to result in an increase in electricity sector emissions to a level that is more than minus 26 per cent of the sector's 2005 levels by 2030. If the program proceeds, we consider a more appropriate and more easily assessed criterion would be a maximum emission intensity value for the project.

The proposed program is significantly different to the ACCC's recommendation

The ACCC's government offtake recommendation is intended to address the current challenges with project financing experienced by both customers and new generation developers. The CEC is concerned that the program objectives outlined in the

[1] ACCC, Retail Electricity Pricing Inquiry – Final Report, July 2018, p. 101.

Consultation Paper significantly move away from the intent of the ACCC's recommendation in several respects. This expansion has not been sufficiently justified.

Firstly, the Consultation Paper introduces a strong objective to improve reliability and security by increasing the level of firm and firmed capacity in the system. To support this, it points to the recent Electricity Statement of Opportunities (ESOO) in which the Australian Energy Market Operator (AEMO) identifies that the NEM needs an additional 1160 MW of dispatchable capacity to enter the market in the next decade to meet the Reliability Standard.

The grave reliability concern that warrants expanding the program's objectives to include reliability is unfounded. In relation to the above ESOO finding, it is important to highlight that the ESOO also indicates that the current Reliability Standard should not be exceeded in the forthcoming outlook period and in fact, any challenges to reliability diminish over the outlook period in part due to investment in renewables and storage. In addition, the ESOO also finds that transmission augmentations and new lines would reduce the need for additional dispatchable capacity and improve reliability over coming years by alleviating transmission congestion, leveraging resource diversity and maximising the value of the existing generation fleet.

Considering the ESOO's benign reliability outlook, it is unclear why an additional initiative to address reliability is required amongst the other existing and proposed reliability mechanisms and initiatives. These include the Reliability and Emergency Reserve Trader (for which enhancements are being considered currently through an Australian Energy Market Commission rule change proposal process), proposed Retailer Reliability Obligation, AEMO's Integrated System Plan (ISP) and the work being undertaken by the Energy Security Board to make the ISP into an actionable strategic plan.

This focus on reliability could lead to unnecessary over-build, particularly given the Consultation Paper does not contemplate a funding or capacity cap for the whole program. This would not be in the long-term interest of consumers.

Secondly, the Consultation Paper suggests the program could be extended to upgrades or life extensions of existing generators. The ACCC's recommendation took a technology-neutral approach for only new generation. Given recent media reports, the CEC is deeply concerned that this expansion of eligible projects is intended to support ageing coal plants that are expected to close in coming years. This is clearly no longer technology-neutral and sharply contrasts with the rationale behind the ACCC's recommendation of supporting sustainable generation projects in order to improve competition. There are several reasons why both new and existing coal projects should not be supported:

- Supporting coal projects beyond their commercial life is unlikely to represent the lowest-cost solution. This was recently demonstrated in the detailed analysis AGL conducted of the relative costs associated with extending the life of the Liddell Power Station compared with replacing it with a combination of renewables, battery storage and gas peaking plant. As a result, this strategy is unlikely to help lower prices for consumers.
- Ageing coal plants are increasingly unreliable with an increasing frequency of generator failures as they approach the end of their technical life. This is most evident on hotter days, which typically coincide with peak demand periods.

Consequently, these generators are unlikely to assist with meeting demand when they are most needed.
- Coal plants are relatively inflexible with an inability to ramp up and down quickly as the system requires. The emerging concerns in the market will best be managed by increasing access to assets that can meet increasing fluctuations in both supply and demand.
- Coal plants are not robust to future policy scenarios that are required to meet Australia's international emissions reduction commitments. Including them will make an orderly transition impossible. Relatedly, recent media reports have indicated that the government may indemnify new generation projects under this program against the future risk of a carbon price. The CEC strongly opposes this, especially as it could result in significant cost to the government and ultimately taxpayers.

The proposed program puts innovation in the corporate PPA market at risk

Businesses across the NEM are using corporate PPAs as a means to underwrite new generation and realise the financial benefits from renewable energy. The rapid growth in the corporate PPA market is being accompanied by innovative contracting terms that are allowing more and more businesses to access these contracts for low-cost generation. For example, since the ACCC report was released there have been announcements of corporate PPAs with terms of less than ten years.[2] These demonstrate that customers and developers are able to reach agreement and access project financing for new projects even when customers are only prepared to commit to shorter-term contracts and only a proportion of the generator's total capacity. Contract innovation is also allowing corporate PPAs that offer a firmness (either physically or contractually) that meets the needs of the customers and facilitate buying group arrangements where a number of smaller customers are able to join together and collectively source their electricity from a single renewable energy project.[3]

The CEC strongly cautions that the proposed program risks this natural innovation already occurring in the corporate PPA market and could impede the rapid growth already evident in this market. This would have the perverse outcome that the intervention represents a significant market distortion that would in fact threaten investor confidence and therefore have a dampening effect on future investment.

Program development should not be rushed

The CEC is concerned by the Government's ambitious timeframe to finalise the program guidelines in January 2019 in order that the first phase of support can commence from 1 July 2019. There is no demonstrated need for such a rushed process. We consider this an insufficient amount of time to fully evaluate the details and potential

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[2] BlueScope has signed a seven-year PPA for 66 per cent of ESCO Pacific's Finley Solar Farm project. See: http://www.escopacific.com.au/wp-content/uploads/2018/07/180720-ESCO_BSL_PPA-Media-Release.pdf

[3] Under the Melbourne Renewable Energy Project, a group of local governments, cultural institutions, universities and corporations have collectively committed to purchase energy from the Crowlands Wind Farm. See: https://www.melbourne.vic.gov.au/business/sustainable-business/mrep/Pages/melbourne-renewable-energy-project.aspx

consequences of the program. It also does not provide adequate opportunity for public consultation.

Complicating any effective program development is the current political environment. It is our strong view that this policy, the collapse of the development of the NEG and the political reality that Australia has had a recent leadership change and a federal election is impending represent too much risk to investors in the energy sector. As a minimum, any progress on a government program should occur after the upcoming federal election.

If you have any questions regarding this submission, please contact Lillian Patterson, Director Energy Transformation, at lpatterson@cleanenergycouncil.org.au or on (03) 9929 4142.

Yours sincerely,

Kane Thornton
Chief Executive Officer