Energy Security Target – Stakeholder Consultation

Alinta Energy Submission

26 May 2017

Executive Summary

Alinta Energy (**Alinta**) welcomes the opportunity to provide comment as part of the stakeholder consultation on the South Australian Government's proposed Energy Security Target (**EST**), which aims to increase competition, put downward pressure on prices and enhance system security and stability.

Alinta recognises that policy makers are concerned about the operation of the National Electricity Market (**NEM**) given increasing electricity prices and the importance of ensuring grid stability and security while delivering on emissions reduction commitments. South Australia is at the forefront of this issue with its high share of renewable generation, increasing prices, and recent system black and load shedding events.

Governments, regulators and policy makers have responded to this issue with an escalating number of reviews and several announcements, not all of which have been well coordinated. In the absence of a coordinated, well thought through national approach the rapid implementation of a scheme of the type contemplated by this policy may have a number of unintended consequences.

Therefore while Alinta supports the South Australian Government pursuing the EST as a potential policy solution, Alinta has concerns with consultation process and pace of change. Specifically Alinta makes the following comments:

- Regulatory uncertainty and inadequate regulatory processes will deter investment. Alinta recommends the progression of the EST should be postponed until after the findings of the three major reviews underway are published to ensure a well thought through and coordinated regime is implemented.
- The timeframe for consultation and implementation has been inadequate for respondents to provide considered views on the scheme. This will ultimately lead to inefficient price outcomes and bill shock for consumers in the first year of the scheme. To avoid this consequence, the start date of the scheme should be delayed until 1 January 2018 at the earliest.
- The proposal may not achieve the government's system stability objective in the most efficient way. Accordingly, alternate schemes should be considered and consulted on.
- The proposal may not achieve its objectives given market concentration in the South Australian generation sector and the lack of liquidity. Alinta believes the scheme should be augmented to provide for a transition to increasing dispatchable and synchronous generation in the state. For example through the flexible banking and loan arrangements referred to below.

While Alinta is not convinced that the EST is the most appropriate scheme, if it were to progress there are a number of detailed issues that need to be resolved immediately. These are:

- The EST should allow for the inclusion of evolving technologies;
- The timeframe for surrendering certificates should be extended;
- The EST should include flexible banking and loan arrangements, which would support further investment by retailers/investors in the sector and allow for a smoother transition; and
- The electricity security fraction should be published in advance for retailer forecasting.

For additional detail please see our complete submission contained in Appendix A.

Alinta welcomes the opportunity to continue to engage with the Department of State Development on this submission.

If you require any further clarification on any of the matters raised please directly contact Michelle Shepherd, General Manager Regulatory and Government Affairs, on 08 9486 3762 or alternatively **michelle.shepherd@alintaenergy.com.au**

Appendix A: Alinta Energy's detailed submission

1. Introduction

Alinta Energy (**Alinta**) welcomes the opportunity to provide comment as part of the stakeholder consultation on the South Australian Government's proposed Energy Security Target (**EST**), which aims to increase competition, put downward pressure on prices and enhance system security and stability.

Alinta recognises that policy makers are concerned about the operation of the National Electricity Market (**NEM**) given increasing electricity prices and the importance of ensuring grid stability and security while delivering on emissions reduction commitments. South Australia is at the forefront of this issue with its high share of renewable generation, increasing prices, and recent system black and load shedding events.

Governments, regulators and policy makers have responded to this issue with an escalating number of reviews and several announcements, not all of which are well coordinated. In the absence of a coordinated, well thought through national approach the rapid implementation of a scheme of the type contemplated by this policy may have a number of unintended consequences.

2. Who is Alinta?

Alinta is both a generator and retailer of electricity and gas in the east and west coast energy markets. It has 1700MW of gas-fired generation facilities, and in excess of 750,000 customers including more than 60,000 in South Australia. Alinta is actively growing its retail and generation position across Australia.

In addition to recent announcements for renewable energy development in Western Australia, Victoria and Queensland, Alinta holds an option to acquire land adjacent to a grid connection point in Port Augusta to develop a large scale solar PV project.

Alinta, the Australian Renewable Energy Agency, and the Government of South Australia recently undertook a joint study into the feasibility of a solar thermal generation facility at Port Augusta. The study concluded that the construction of a solar thermal facility was not commercially feasible at the time[1]. However, Alinta is still considering options for solar thermal in that region.

At the other end of the renewable scale, Alinta has a residential solar PV business in Western Australia and is currently assessing the feasibility of offering residential battery systems in the future. Alinta recently launched a similar business in South Australia under a brand licencing agreement with a major Australian retailer, which will be progressively rolled out across the remainder of the eastern seaboard, in coming years.

The diversity of Alinta's portfolio, its investment strategy, product offerings, and first hand experiences means that we are well placed to provide informed comment to the consultation on the South Australian Government's proposed EST.

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[1] For more information see: https://alintaenergy.com.au/wa/about-us/power-generation/port-augusta-solar-thermal

3. Key concerns

While Alinta supports the South Australian Government pursuing the EST as a potential policy solution, Alinta has concerns with consultation process and pace of change.

Further, Alinta is not convinced that the EST will achieve the South Australian Government's objectives and considers that it will lead to inefficient pricing outcomes (at least in the short term), sub-optimal dispatch outcomes, increased uncertainty and deter new investment in generation in the South Australian market.

Regulatory uncertainty and inadequate regulatory processes will deter investment

Alinta recognises that action is needed to prevent recent South Australian issues from reoccurring. However, Alinta is concerned with the South Australian Government's unilateral decision to progress a state based regime, to be implemented in an extremely short timeframe, and with no consultation on what would be the most optimal approach to addressing the issues.

The quality and stability of regulatory decision making is vital for the electricity sector given the long asset lives and the impact of regulatory uncertainty can have on the willingness for investors to commit significant capital. As noted by former Australian Minister for Resources and Energy, Hon Martin Ferguson[2], in terms of the energy market reform process in Australia:

> 'To the extent reform is necessary [businesses] want it to be gradual and consensual, enabling them time to adjust… The focus of reform should be on a process of continuous learning rather than throwing the rule book out at the first sign of trouble…legitimacy and quality of policy outcomes ultimately depend on proper process being observed.'

There is no doubt that action needs to be taken, however there are three major reviews of system security underway which will address the very issues the EST is purported to address: the Finkel review, the AEMC's System Security Market Frameworks Review and AEMO's Future Power System Security Program. All three reviews are expected to provide recommendations in mid-2017.

The South Australian government is introducing significant regulatory uncertainty by introducing a state based mechanism with such a short implementation period where stakeholders simply do not have time to fully understand the implications of the scheme. Furthermore, the Government's consultant has stated that the EST could be replaced within a short period of time, for example if the Finkel Review recommended a national Emissions Intensity Scheme. This is an inefficient use of resources and presents significant regulatory uncertainty, which in turn is unlikely to attract investment.

Although Alinta supports measures to ensure system security and stability, it believes this would be most efficiently and effectively achieved through a single national program which we expect from one of the three major reviews nearing recommendation stage. This will ensure that alternative directions for the markets development are not taken in quick succession given the associated implementation costs and investment uncertainty this would create. Further, an integrated national

[2] Hon Martin Ferguson, Australian Financial Review 17 September 2013 'Good energy policy must be marinated' http://www.afr.com/p/australia2-0/good_energy_policy_must_be_marinated_6CcFPIYCvvdN03ZlvhOb3O

approach avoids complex interactions between various programs that could also increase uncertainty and further deter investment.

On this basis Alinta recommends that the progression of ETS should be postponed until after the findings of the three major reviews underway are published.

The timeframe for consultation and implementation is sub-optimal, which will ultimately lead to inefficient price outcomes and bill shock for consumers in the first year of the scheme

Retailers are currently faced with the prospect that the obligations associated with the ETS could commence in a little over 6 weeks. Alinta is extremely concerned that the speed at which this is progressing and considers that this will ultimately result in inefficient price outcomes for consumers. This is because retailers and generators do not have enough time to both fully understand the implications of the scheme or negotiate certificate prices[3].

The inability for retailers to negotiate certificate prices and the absence of a trading platform (at least initially) leads to a very real likelihood that retailers will price EST certificates at the cap in annual price resets that are happening right now. Alinta considers that this will add around $90 – $100 to each customer's bill annually. This is an inefficient price outcome for consumers and should be avoided.

Further to this, most retailers will have already hedged a significant portion of their forecast FY18 loads, and therefore the rush to implement the scheme will not allow enough time for any potential reductions in wholesale prices to be reflected in the strike prices in hedging products, therefore increasing the risk of bill shock in the first year of the scheme.

If the scheme were to be implemented Alinta considers that further time is required for retailers to understand the implications of the scheme, identify the full list of eligible generators, negotiate efficient certificate prices with eligible generators, include efficient costs in their retail prices, inform customers of the introduction of the EST and upgrade billing systems in an efficient and orderly manner. This additional time will also allow the Essential Services Commission of South Australia (**ESCOSA**) time to develop, and consult appropriately, on the outworkings of the scheme. As an absolute minimum, the start date for complying with the Target must be deferred until 1 January 2018.

The proposal may not achieve the government's system stability objective

The EST is designed to ensure that a certain percentage of South Australia's electricity demand is met through South Australian based "clean" but dispatchable generation, which can provide local security services of fault current and inertia.

Alinta considers that targeting MWh does not necessarily guarantee the system security outcome the State Government is trying to achieve. Targeting a MWh level of specific generation does not necessarily ensure there is sufficient inertia in the system when it is required. For example, the 4,500GWh equates an average load of ~500MW. State average demand is about 1400MW. So, if gas generators all bid into the market to get dispatched first, the 4,500GWh target could potentially be

[3] There is anecdotal evidence that incumbent South Australian generators will be offering prices at just below the cap.

met in 4 months. Such a scenario (although unlikely) could still conceivably mean that there is insufficient inertia at particular points in time. Alinta considers that an MWh generation target is a poor mechanism to ensure sufficient inertia exists when it is required.

As outlined in its submission to the Finkel Review, Alinta supports implementation of some sort of reward structure that reflects the value that important grid support services (such as inertia and frequency control) provide to the system. This could be via a market based mechanism i.e. ancillary services market, a reverse auction for spinning reserve services, or via a capacity payment of some sort. However, whatever scheme is chosen, the overarching principles that should be applied are for sufficient inertia to be procured at minimum cost and that the inertia needs to be available when it is required.

Achieving the EST's objectives will be impacted by market concentration in South Australia

The South Australian generation sector is concentrated, with one dominant participant and three significant participants.

Given the market concentration in South Australia, Alinta is concerned that the most efficient outcomes for the market may not always be achieved due to the lack of liquidity

These liquidity issues are already evident, with anecdotal prices for certificates just below the market cap of $50.

Alinta considers that the issues associated with market concentration will need to be considered to ensure the EST achieves its objective. Alinta believes the scheme should be augmented to provide for a transition to increasing dispatchable and synchronous generation in the state. For example through the flexible banking and loan arrangements referred to below.

4. Specific comments on the EST

While Alinta is not convinced that the EST is the most appropriate scheme, if it were to progress there are a number of issues that need to be resolved immediately.

The EST should allow for the inclusion of evolving technologies

Spinning turbines provide "real inertia" and battery storage can provide what is known as "synthetic inertia" or "fast frequency response". Alinta notes that fast frequency response and battery storage can play a significant role in the provision of inertia and the management of the grid. It fills in the gap between a major fault and the relatively slow response of the governors that control the gas turbines. However, the current EST framework excludes battery storage which makes solar and wind farms paired with the technology ineligible to receive credits[4].

Alinta considers that policy should be flexible enough to reflect the transitional nature of the problem and allow innovative solutions as technology advances. Flexibility is needed to adjust the detail of policies from time to time in response to evolving technologies and circumstances and as information unfolds about the costs and other impacts of policy.

[4] Excluding alternative technologies exacerbates the market concentration issues outlined in section 3 of this submission.

Alinta recommends that the EST is implemented in such a way to either recognise the alternative technologies that currently exist, or at the very least the EST should transparently set the process that will be followed in order determine viability of alternative technologies.

The timeframe for surrendering certificates should be extended

As outlined in the *Electricity (General) (Electricity Security Target) Variation Regulations 2017* (**draft regulations**) a retailer must, within 1 month after the end of a financial year surrender to ESCOSA the number of certificates equal to its annual liability for that financial year.

Alinta notes that certain meters will not have been read in the short timeframe which will require retailers to calculate on estimates. There seems to be little to be gained by imposing such a short timeframe and we recommend increasing the default timeframe to 3 months.

The EST should include greater banking and loan arrangements, which would support further investment by retailers/investors in the sector and allow for a smoother transition

As outlined in the draft regulations a retailer must, within 1 month after the end of a financial year surrender to ESCOSA at least 90% of certificates equal to its annual liability for that financial year, with future years' liability including any electricity security certificate shortfall or excess from a previous financial year. What is not clear from the draft regulations is how long any electricity security certificate shortfalls or excess can be carried over for.

In order to maximise the successful participation in the scheme, Alinta considers an important element for consideration in the EST is building in the flexibility to 'make good' on previous shortfalls over a longer period of time (for example, three to five years).

Alinta considers that this would support investment by retailers/investors in the sector and allow for a smoother transition.

Alinta believes that this flexibility is not only critical to the successful participation of growing Tier 2 retailers in the EST, but will also increase the certainty for the business to build a case for future investment in the state.

The electricity security fraction should be published in advance for retailer forecasting

The electricity security fraction which will be included in the liability calculation is based on dividing the electricity security target (for the financial year) by the aggregate of the liable load for all NERL retailers operating in South Australia in the previous financial year. The *Electricity (General) (Electricity Security Target) Variation Regulations 2017* do not make it clear when this will be published which will be challenging for retailers to forecast and calculate the implications for retail costs.

Alinta strongly recommends that the electricity security fraction be published in advance in order to allow retailers to include in their forecasts.