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Submission to Capacity Mechanism Project Initiation Paper

TransGrid welcomes the opportunity to respond to the Energy Security Board's (ESB's) Capacity Mechanism Project Initiation Paper. This paper is the first stage of the ESB's project to address a request from Energy Ministers that the ESB develops the detailed design of a mechanism that explicitly values capacity in the National Electricity Market.

TransGrid is the planner, operator and manager of the high voltage transmission network connecting electricity generators, distributors and major end users in New South Wales and the Australian Capital Territory. Our network is also interconnected to Queensland and Victoria, and is instrumental in ensuring that the electricity system facilitates reliable, low emissions and affordable electricity supply for consumers. In this context, Transgrid has a strong interest in ensuring that the wholesale electricity market is also effective in contributing to these objectives.

Transgrid understands the problem that a capacity mechanism is seeking to solve. There is no doubt that the NEM is rapidly transitioning to a lower-emissions generation profile, characterised by higher levels of near-zero marginal cost variable renewable generation. This transition raises an important question about the ability of the energy-only wholesale electricity market to remunerate capacity and achieve 'resource adequacy'. As zero or negative prices arise in more trading intervals¹, peak prices in an energy-only market would need to increase in order to ensure resource adequacy. It is unclear whether such prices would be effective in providing the right mix of capacity or whether the greater volatility in wholesale prices would be acceptable to stakeholders.

While Transgrid understands the problem the ESB is seeking to solve through the development of a capacity mechanism, the optimal solution is much less clear and requires careful consideration. For example, while Transgrid supports the orderly transition to renewables, it does not necessarily follow that paying ageing coal fired generators to stay in the market will benefit consumers. As such, it is important that the ESB's examination of the detailed design for a capacity mechanism does not lose sight of the broader question of whether a capacity mechanism will achieve the desired outcome from the perspective of consumers. In making this observation, Transgrid notes the ESB's observation that stakeholders have questioned whether it would be preferable to adjust the current market settings, rather than introduce a capacity mechanism.

¹ AEMO recently reported that wholesale electricity prices were negative or zero in 16% of trading intervals in the September 2021 quarter, which is more than double the previous record of 7% in Q4 2020.

Transgrid also notes that the case for a capacity mechanism needs to be established in the context of the current developments across the jurisdictions, where Renewable Energy Zones are being developed and access arrangements introduced to manage the orderly connection of generation and storage capacity. In contrast to these Government-led initiatives, a capacity mechanism would seek to refocus attention on the market price for capacity as the best means to obtain resource adequacy. By its nature, the success of this kind of initiative depends on all parties, including investors, consumers, regulators and Governments having confidence in the market mechanism to achieve its objectives. If confidence in market prices cannot be maintained, then the capacity mechanism will prove to be ineffective.

Given the above observations, Transgrid supports the ESB's detailed examination of how a capacity mechanism could best be implemented in the NEM. However, the ESB should also continue to examine the case for introducing a capacity mechanism as it works through the detailed design. In this context, Transgrid welcomes the opportunity to participate actively in the ESB's work program with a view to making a constructive contribution to this important review. In particular, Transgrid would like to participate in the technical working group(s) to be established by the ESB, so that we can ensure that transmission related issues are fully considered in the design process.

If you require any further information or clarification, please feel free to contact either me at eva.hanly@transgrid.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read "E Hanly", written in a cursive style.

Eva Hanly

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