

Our ref: P529/20F25
19 October 2020
By email: info@esb.org.au

Re: **Reliability Panel response to P2025 Market Design Consultation Paper**

Dear Energy Security Board Chair and members,

The Reliability Panel thanks the Energy Security Board (ESB) for the opportunity to make a submission on its Post 2025 Market Design Consultation Paper. The Panel also greatly appreciated Dr Schott, Mr Swift, Mr Garbutt and Ms Ogilve coming to present and discuss the consultation paper with the Panel at its recent Away Day in September 2020.

As the ESB would be aware, the Panel has an important role in the NEM's governance structure regarding reliability and security. The foundation of the Panel's role is making decisions and providing advice that focus on system security, reliability and safety outcomes that are in the long-term interests of consumers. On this basis, the Panel offers the following comments on the market design initiatives and issues raised in the ESB's post 2025 work.

Sequencing and alignment with RSSR

As was recognised in the ESB's consultation paper, the Panel has an upcoming work program that complements and is interdependent with the ESB's work. Our work brings an opportunity to examine what a particular market design may mean for the detailed operation of the reliability and security frameworks.

Of most note, is the Panel's upcoming *Reliability standards and settings review* (RSSR). This is a review that the Panel must complete every four years under the National Electricity Rules (NER). It examines whether the reliability standard (currently 0.002% unserved energy) and the reliability settings (market price cap, price floor, administered price cap and cumulative price settings) remain fit for purpose.

The next RSSR pertains to the reliability standard and settings to be in place from 1 July 2024 – 1 July 2028, within the "post-2025" window.

As the ESB is aware, there are fundamental interdependencies between the market design initiatives being considered by the ESB and the reliability standards and settings. For instance, several of the initiatives (such as new markets for essential system services and a two-sided market) would likely impact on supply-side (including storage) revenue streams. This in turn would likely impact on the optimal reliability settings for the market.

We note the two proposed options for resource adequacy mechanisms that the ESB is committing to explore further is a modified RRO or decentralised capacity market. Our preliminary reaction is that these could impact on the level of the reliability standard as well as the market price settings. The Panel will need to understand the scope of possible reforms under 2025 before considering the reliability standard and settings in detail.

The Panel considers that the current timeframes for the ESB's work are very well aligned to allow the necessary coordination between the P2025 design and the Panel's RSSR. While the Panel's work on RSSR will commence in early 2021, the ESB's final 2025 market design advice is due to Energy Ministers by mid-2021. This will allow the Panel to consider how the final post 2025 market design will impact on the reliability standards and settings before completion of the review by April 2022 (as required by the NER). This current alignment in sequencing will minimise investor uncertainty and the risk of inefficient market outcomes.

Future-focused, holistic market design

In the context of RSSR, the Panel will consider the best approach to thinking about reliability, given the changing power system and post 2025 market design. A key aspect is whether the current formulation of the reliability standard remains appropriate, particularly in an environment with increasing uncertainties and concerns regarding tail risks.

In the RSSR review we will consider questions including:

1. What current and emerging problems is the NEM facing that may require changes to the reliability standard and/or the reliability settings? The work the ESB is doing on the drivers of change for future market design will be invaluable in considering this question.
2. How does the reliability standard interact with the market's reliability settings, other aspects of the (post-2025) reliability framework, and broader future market design? Again, this work will draw upon and consider the ESB's work on the direction of the market design.

Through RSSR, and additional work streams as needed, the Panel will contribute thought leadership that is firmly future-focused. This includes preparatory work as an initial step of next RSSR, including for example, developing a more holistic and broader review scope to ensure that the approach and measures developed for reliability and security in the future will be suitable for the evolving direction of the power system. There is good alignment between this and the ESB post 2025 project, since we would expect that this work would benefit from close collaboration with the ESB, including understanding the perspectives and experience gained by the ESB from the recent investigation into the interim reliability measures.

The Panel considers that it may be timely in some areas to compare a breadth of options for their relative efficiency and effectiveness, and identify and evaluate duplicative mechanisms. In the Panel's view, one area where such a more holistic view may be beneficial are proposed interim changes to the Retailer Reliability Obligation (RRO). The potential options to address the issues could be broadened to mechanisms beyond the RRO, and links to other potential reliability reforms re-examined. To the extent the Panel could contribute to a discussion of broadening of options, or potential overlaps between initiatives, we would be happy to offer our sector-wide perspective.

A commitment to collaborative market design

The Panel is committed to undertaking its work collaboratively with the ESB and others to progress effective market reforms. We welcome the opportunity to work closely with the ESB throughout the coming months – including by holding regular workshops with the ESB to work through some interdependency issues on RSSR and check-ins on the workstreams. This will allow the market design to be developed in a cohesive fashion.

Further into the future, the Panel is to commence a review of the Frequency Operating Standard (Q4 2020). This will follow AEMO's finalisation of related investigations and progress by AEMC on the frequency control rule changes. The "FOS review" is consistent with the frequency work plan set out by the ESB and is being coordinated with other work already underway.

The Panel is also planning to review the RERT Guidelines, which provide guidance to AEMO and market participants about how the RERT is used and operates. The Panel notes that the ESB wishes to consider whether the RERT processes are efficient as possible – this review should be an opportunity to make changes to further refine the processes to make them more efficient, incorporating recent learnings and experience.

System services – operations key and contestability not a 'one size fits all'

Front of mind for the Panel is getting power systems operations right to address current and future challenges in the area of system security. The Panel recognises the immediate need for pragmatic, well-targeted operational solutions as the power system evolves.

The Panel also recognises that in the medium term, contestable policy approaches may be needed in some areas alongside improved power system operations.

The Panel supports the use of contestable approaches for essential system services; and markets where they can be proven to be beneficial for a particular service given its specific context and nature. Tendering for services rather than a market, for instance, may be more appropriate for some services, particularly depending on the technology options that exist at a particular point in time.

Clearly defining the services needed, comparing efficiency gains to implementation costs, and examining factors such as how locationally-bounded service provision needs to be, will be critical in finding the most effective contestable approach and minimising costs for consumers.

We note the importance of technological development for some services (for example, system strength) and would encourage the ESB to design these markets such that the provision of essential system services can evolve over time alongside technological advances.

Backstops should not 'bind' as primary mechanisms

Finally, we note there is commentary in the section of the consultation paper on the resource adequacy mechanism initiative about the nature and operation of backstop mechanisms as the NEM evolves.

The Panel considers that while some backstop mechanisms may be necessary for the transition, over time these backstop mechanisms should be minimised. They should not 'bind' as primary mechanisms in the NEM.

To the extent that backstop mechanisms do exist, they should be designed as structures distinct from normal market operation and be designed so as to avoid any distortions to the market. This will increase investor certainty and promote investment.

The Panel considers therefore that the ESB's work should be focussed on putting in place mechanisms to deliver resource adequacy and essential system services in the wholesale market, rather than through backstop mechanisms. Making sure the market is effective in the first place will minimise the likelihood that backstops are used.

Thank you once again for the opportunity to provide a submission. If you have any questions, please do not hesitate to contact me to discuss.

Yours sincerely



Charles Pople

Chair, Reliability Panel