



Australian Energy Market Commission

Level 6, 201 Elizabeth Street Sydney NSW 2000
PO Box A2449, Sydney South NSW 1235

P – 02 8296 7800

F – 02 8296 7899

E – aemc@aemc.gov.au

ABN 49 236 270 144

www.aemc.gov.au

Our ref: 17-24464

14 November 2017

Peggy Danaee
Committee Secretary
Standing Committee on the Environment and Energy
PO Box 6021
Parliament House
Canberra ACT 2600

By email: moderngrid@aph.gov.au

Dear Committee Secretary

Questions on Notice: inquiry into modernising Australia's electricity grid

I am pleased to respond to the questions asked of the Australian Energy Market Commission (AEMC) as part of the House of Representatives Standing Committee on the Environment and Energy's inquiry into modernising Australia's electricity grid. These questions have been asked by the Chair of the committee on behalf of members who were unable to attend the AEMC's third appearance before the committee at a public hearing on 26 October 2017. Please find answers to the questions below.

1. Regarding 5 minute settlements, can AEMC please explain why the long implementation period is required?

The AEMC published a draft rule in September proposing to move from 30 minutes to five minute settlement. This would align the market price signals with the actual physical needs of consumers and the system.

The final determination will be published on 28 November. If the final rule is consistent with the draft, it will provide a signal for the market to invest in flexible plant that can adjust over five minute periods. We would expect to see some of that investment immediately even though the rule is unlikely to start on that day.

Moving to five minute settlement is a fundamental change to the energy market as it will change the nature of transactions between all market participants; involve upgrades to infrastructure, equipment and software systems as well as significant behavioural changes within businesses on the supply and demand side. An implementation period will allow the national electricity market capture the benefits of the change without imposing undue cost and risk.

Specifically, the implementation period will allow for:

- IT systems transition and testing;
- forward contracts to be transitioned in an orderly manner;
- solutions to outstanding system security and reliability issues to be implemented;
- new technologies to be sufficiently established in the NEM.

The Commission believes a transition period of three years and seven months is the shortest timeframe possible to implement the required changes, while managing the considerable practical challenges, risks and costs the change presents. This timeframe is consistent with international experience for changes of a similar nature.

2. Regarding market rule changes, can AEMC you please outline the biggest challenges in making rule changes, identify the most time-consuming elements of the rule change process, and identify the best opportunities for streamlining the process?

Consistent with its obligations under law as well as well as sound regulatory practice, the AEMC has rigorous processes in place to properly define and consult on the problems presented to it as part of rule change requests, and develop workable and lasting solutions. The time taken to make rules reflects the complexity of the problem reflected in a rule change request and implications of any solutions suggested.

For example, the AEMC recently published six rules under an "expedited"¹ process and one fast-tracked rule². On the other hand, rules that change the fundamental nature of the market need more time particularly to give stakeholders enough time to engage meaningfully in the process.

Submissions³ made to the COAG Energy Council in September 2017 in relation to a proposed broad rule-making power for the SA Minister, based on advice from the Energy Security Board (ESB) noted the importance of the AEMCs consultation with stakeholders when considering energy market reforms. Some extracts from submissions have been included below.

Public Interest Advocacy Centre: PIAC is of the view that...the AEMC should retain jurisdiction over all of the Rules to ensure that all stakeholders can still propose changes under a well-defined and public consultation processes.

South Australian Council of Social Services: We believe the current consultation process which the AEMC undertakes is essential for transparency and to ensure that consumers have a say in rule changes which directly impact on them. Over time, the AEMC has enhanced and improved its consultation processes and we would not want to see that compromised.

Jemena: Similarly, the existing rule-making processes followed by the AEMC provide opportunities for comprehensive stakeholder consultation, including through the publication of explanatory determinations and proposed rule drafting.

Energy Australia: The AEMC rule change process has been established to ensure thorough consultation and cost/benefit analysis are undertaken before changes can

¹ Expedited rules completed 2017/18 financial year: ERC0221 – Classification of loads as ancillary service loads; GRC0042 – Changes to periodic review of market parameters in STTM; ERC0224 – Pricing during market suspension; ERC0223 – Application of rate of return guidelines to TasNetworks; RRC0010 – Notification of end of fixed benefit period; GRC0041 – Unintended scheduling result – decision timing.

² Fast-tracked rules completed 2017/18 financial year: GRC0040 – Improvements to natural gas bulletin board

³ <http://www.coagenergycouncil.gov.au/publications/energy-security-board-ministerial-power-make-rules>

be made to the NEM. It is a multi-phased process that is well understood, evidence-based, consultative, and based on stakeholder input.

The rule change process is just one part of the overall process to reform regulatory frameworks. A complex problem may involve a review, stakeholder consultation, and consideration and agreement from Energy Council before being submitted to the AEMC as a rule change request. Therefore the time between an issue being identified, and a new rule being implemented will reflect all of these stages, not just the rule change process itself.

3. Regarding the abolition of limited merits review, can AEMC outline how the benefits are likely flow to consumers and over what time period?

On 10 August 2017, in his second reading speech⁴, the Minister for the Environment and Energy outlined the benefits the Commonwealth Government expects to see as a result of the abolition of limited merits review as set out in the *Competition and Consumer Amendment (Abolition of Limited Merits Review) Bill 2017* (the Bill). The bill digest⁵ also outlines the expected benefits resulting from this change.

On 7 September 2017, the Senate referred the Bill to the Senate Environment and Communications Legislation Committee for inquiry. The Committee recommended that the Bill be passed and included reasons, including the expected benefits for consumers in its report of 16 October 2017.

The Australian Energy Regulator (AER) is the economic regulator for the energy market and a more appropriate body to consider the benefits expected as a result of this change.

4. Which part of the documents creating and enabling the ESB permits the ESB to prepare advice for one member of COAG without other members being informed or involved?

The COAG Energy Council established the ESB in August 2017. Terms of reference outlining the functions and responsibilities of the ESB will be published on the COAG Energy Council's website.

5. Who prepared the first draft of the ESB 8 page NEG letter dated 13 October 2017?

The letter dated 13 October 2017 was advice developed by the ESB. The three market bodies support the ESB Chair, Deputy Chair and activities with staff and other resources as appropriate.

6. How much time did AEMC officers or staff spend preparing the advice?

AEMC staff provide advice to the AEMC Chair who is a member of the ESB. The three market bodies support the ESB Chair, Deputy Chair and activities with staff and other resources as appropriate.

⁴ [http://parlinfo.aph.gov.au/parlInfo/search/summary/summary.w3p;query=BillId_Phrase%3Ar5929%20Title%3A%22second%20reading%22%20Content%3A%22I%20move%22%7C%22and%20move%22%20Content%3A%22be%20now%20read%20a%20second%20time%22%20\(Dataset%3Ahansard%20%7C%20Dataset%3Ahansards\)](http://parlinfo.aph.gov.au/parlInfo/search/summary/summary.w3p;query=BillId_Phrase%3Ar5929%20Title%3A%22second%20reading%22%20Content%3A%22I%20move%22%7C%22and%20move%22%20Content%3A%22be%20now%20read%20a%20second%20time%22%20(Dataset%3Ahansard%20%7C%20Dataset%3Ahansards))

⁵ http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=BillId_Phrase%3A%22r5929%22%20Dataset%3Abillsdqs;rec=0

7. When were ESB members first provided with the draft advice?

The ESB first met in August 2017. The ESB developed its advice through meetings and discussions and based on the collective knowledge and experience of the three market bodies.

8. How was the decision arrived at in the ESB advice to assign the electricity sector obligations in national emissions reduction proportionate to the sector's emissions, as opposed to for example the sector's capacity to reduce emissions?

Australia's emissions reduction commitments are a matter for government. The AEMC has consistently highlighted this as an appropriate allocation of responsibilities under the energy governance framework.

9. As a matter of course, does the AEMC make any assumptions in its modelling about the proportion of national emissions reductions to be attributed to the electricity sector?

Australia's emissions reduction commitments are a matter for government.

10. When having regards to the '2 degrees' target in the Paris agreement, what does the AEMC consider the emissions reductions targets for the electricity sector should be, in 2030 and beyond?

Australia's emissions reduction commitments are a matter for government to decide. The AEMC's role is to provide advice and develop rules to achieve the national energy objectives, that is, to promote efficient investment in, and efficient operation and use of, electricity [or natural gas or energy services] for the long term interests of consumers with respect to price, quality, safety, reliability and security of supply.

The AEMC's interest is therefore in making sure mechanisms that seek to achieve emissions reductions from the energy sector integrate with energy markets to meet the required emissions reductions while maximising the achievement of these energy objectives.

11. Does the AEMC agree with the Climate Change Authority that Australia has a 'carbon budget'? If so, how much is it?

Australia's emissions reduction commitments are a matter for government. International commitments are often translated into carbon budgets for modelling purposes to understand policy options more comprehensively.

12. Does the AEMC agree with the CCA that the electricity sector will need to reduce emissions between 45 and 65 per cent by 2030 consistent with a 2 degree target? If not, why not?

Australia's emissions reduction commitments are a matter for government.

13. In what year does the AEMC consider Australia needs to reach zero net emissions?

Australia's emissions reduction commitments are a matter for government.

14. How was the figure of 28-36 per cent renewables by 2030 on page 8 of the letter arrived at? What analysis or modelling was relied upon? If any of that analysis or modelling is not publicly available, would you please provide it to the Committee?

The ESB's initial advice estimated that the guarantee could lead to renewable energy generation in the order of 28-36% renewables. This was initial advice, provided to governments to give an idea of the potential levels of renewables that may result under a policy like the guarantee and inform early policy discussions. The estimates are based on work over the last two years on various different mechanisms and scenarios, including the AEMC's advice on the Integration of energy and emissions reduction policy (December 2016) and the AEMC/Climate Change Authority joint advice (June 2017). These reports are publically available on the AEMC's website.

Ahead of the COAG Energy Council meeting in November 2017, the ESB has been asked to explicitly model the power mix and price outcomes that are expected under the guarantee, consistent with the Commonwealth government's Paris commitment for emissions reductions of 26-28% below 2005 levels by 2030.

15. Given that the 28-36% renewables may result in less renewable energy than the 35% forecast under the 'Business as usual' scenario at page 93 of the final Finkel report, can the AEMC explain how it considers having less renewable energy in the system than under current policies is appropriate?

The NEG is a mechanism to achieve a reliable power system while achieving the emissions reduction target set by the Commonwealth Government. As part of the objective is to reduce emissions it is an emissions reduction policy instrument rather than an industry policy mechanism to support particular technologies.

The ESB's initial advice estimated that the guarantee could lead to renewable energy generation in the order of 28-36% renewables.

This is not a target, nor a limit on the amount of renewables that could result over time. The ultimate mix of variable and dispatchable generation will be determined by the market, which will be incentivised to deliver the lowest cost combination of technologies to meet the emissions levels required while maintaining reliability.

Ahead of the COAG Energy Council meeting in November 2017, the ESB has been asked to model the power mix and price outcomes that are expected under the guarantee, consistent with the Commonwealth government's Paris commitment for emissions reductions of 26 – 28 per cent below 2005 levels by 2030.

16. What process and consultation would the AEMC use to develop the standard for the reliability guarantee referred to in the ESB NEG proposal?

This is a matter for the ESB and the COAG Energy Council subject to a decision from the Council on whether to proceed to the detailed design stage of the mechanism. We would expect there to be wide consultation across all industry stakeholders and consumer groups.

17. Does the emissions reduction target for the NEG to need to be set by the Federal government? Is this a legal requirement or a policy decision? Does it need to be in legislation?

Australia's emissions reduction commitments are a matter for government. The ESB has set out a governance framework in initial advice. The COAG Energy Council will decide whether to proceed to the next stage of detailed design at which point these matters will be considered further.

18. Has the AEMC previously modelled changes in the electricity market using an assumption of no emission reduction after 2030?

The AEMC undertakes multiple pieces of modelling using a range of assumptions depending on the nature of the work and any terms of reference provided.

If you have any questions or require further information please contact me on _____ or email _____

Yours sincerely

Anne Pearson
Chief Executive