

11 February 2021



Sebastien Henry
Australian Energy Market Commission

Submitted via website.

Dear Sebastien Henry,

Reserve services rule changes directions paper

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) directions paper on rule changes to introduce ramping services and to establish an operating reserve market.

General principles for the provision of system services

In the coming decade, variable generation will increase and high price events will be harder to predict on the basis of high demand and low generation alone as diurnal and seasonal factors influence the state of charge of energy storage systems. With this uncertainty, peaking plants are an increasingly risky investment in an energy-only market. Signalling an energy-only price to a market where variable sources have no marginal cost, and dispatchability is in short supply, is inefficient.

PIAC considers new price signals are needed to ensure the availability of flexible generation, storage and demand side resources. Any capable provider should be eligible to participate in a flexibility market and receive 'flexibility' payments. The flexibility market should aim to incentivise new sources to enter the market where they would not have otherwise. It should not prioritise any particular provider, particularly not incumbent fossil generators which will become less common as the energy system transitions to zero-emissions.

On this basis, PIAC does not support Delta Electricity's proposal for a ramping service as it limits the provision of this service to dispatchable in-service generators.

Price signals are a preferred means to ensure the optimal mix of flexible generation, storage and demand side resources and should be pursued where net benefits justify their introduction. The framework for providing system services should also err on the side of creating a price signal to provide a service rather than setting a mandatory

Level 5, 175 Liverpool St
Sydney NSW 2000
Phone: 61 2 8898 6500
Fax: 61 2 8898 6555
www.piac.asn.au
ABN: 77 002 773 524

requirement, as well-functioning markets are typically better able to adapt and reflect changes in value of a service.

Adaptable prices are important for the long-term interest of consumers. Price adaptability is often compromised by over-reliance on forecasts, or the prioritisation of investment certainty for service providers. Adaptability should be built into the market design to avoid locking in prices that are above the value placed on them or recovered inefficiently. A future market design should ensure prices respond to changes in value as they occur, and are recovered from those who benefit.

Emissions and climate considerations

Australia is a signatory to the Paris Agreement, which aims to reduce global warming to 1.5 degrees.¹ This requires a shift away from fossil fuel energy sources to zero emissions energy sources and systems. Developed countries like Australia are to take a lead in reducing emissions.²

Numerous bodies have warned cuts well above that will be required by 2030 to avoid crossing the 2°C threshold (let alone 1.5°C) by 2100. A recent report released by the Climate Targets Panel found:

To be consistent with the Paris Agreement goal of limiting global warming to well below 2°C, Australia's 2030 emissions reduction target must be 50% below 2005 levels. A 2035 target would need to be 67% below 2005 levels. Net-zero emissions would need to be reached by 2045.

To be consistent with the Paris Agreement goal of limiting global warming to 1.5°C, Australia's 2030 emissions reduction target must be 74% below 2005 levels, with net-zero emissions reached by 2035.

A simple 'net-zero emissions by 2050' target for Australia is not sufficient for the Paris Agreement goal of limiting global warming to well below 2°C (nor 1.5°C).³

We note that these targets are 'economy-wide' targets, and many argue the electricity sector can and should transition faster than other sectors, including gas, in which the relative cost of achieving zero emissions is higher.

The federal government has recently indicated support for reaching net zero-emissions by 2050, and most jurisdictions, including Australia's largest states, have committed to net-zero by 2050 or sooner.

Irrespective of whether any one Government's policy effectively meets the Paris Agreement (or equivalent) at any given time, the continued rapid replacement of fossil fuels with renewable energy in the system is inevitable and necessary, and this is broadly reflected in state and territory government policies.

From a risk management perspective, a future market design that does not economically co-optimize growth in renewable generation with firming sources, such as batteries, and balancing sources, like transmission interconnection and demand response, leaves consumers vulnerable to avoidable cost increases.

¹ The Paris Agreement, <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>.

² Ibid.

³ Climate Targets Panel Report, January 2021. *Australia's Paris Agreement Pathways: Updating the Climate Change Authority's 2014 Emissions Reduction Targets*, 6.

PIAC strongly recommends the AEMC consider a managed trajectory of accelerated emissions reductions in line with limiting global warming to 1.5°C as a factor in assessing the merits of the reserve services proposals.

Risk and cost allocation

PIAC considers that risk should be borne by those best placed to manage it. Distinct from the allocation of risks, is the recovery of costs – noting that while costs and risks are generally related, they are not necessarily the same. PIAC supports a ‘beneficiary-pays’ approach to cost allocation meaning costs should be recovered based according to who benefits from them.

Risk allocation and cost recovery in a market for system services would therefore need to reflect:

- The need for system services and/or the unit cost to provide them may not increase indefinitely and could conceivably be low again. Therefore, market or price settings must be able to move upwards and downwards in response.
- The quantum and distribution of benefits of system services may substantially change over time.

Timing of rule change progress

Many of the rule change proposals seek to create or substantially amend existing markets to provide system services. PIAC considers that, unless trivial, adaptable or urgently required for system security, these should not progress in advance of more strategic and comprehensive market design processes such as the ESB’s Post-2025 market design.

Locking in specific arrangements for system services now may compromise the effectiveness of more efficient, holistic frameworks for the NEM later and may need to be substantively revised or removed in the near to medium term. Either outcome may add otherwise avoidable costs and risks for consumers or investors (or both). It may also complicate the ability of the system to manage increasing numbers of electronic rather than mechanical equipment. Ultimately, this would delay the transition to a low cost and low emissions NEM.

PIAC welcomes the opportunity to discuss these matters further with the AEMC.

Yours sincerely

Anna Livsey
Policy and Communications Officer
Public Interest Advocacy Centre

Direct phone: +61 2 8898 6520
E-mail: alivsey@piac.asn.au