



Committee Secretary
Joint Committee of Public Accounts and Audit
PO Box 6021
Parliament House
CANBERRA ACT 2600

29th January 2021

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https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Public_Accounts_and_Audit/RegulatoryActivities

Dear Sir/Madam,

Regulation of the National Energy Market

The Australian Energy Council (the “**Energy Council**”) welcomes the opportunity to make a submission in relation to the Joint Committee of Public Accounts and Audit’s inquiry into the Auditor-General’s Report on the *Regulation of the National Energy Market – Australian Energy Regulator*.

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia, sell gas and electricity to over ten million homes and businesses, and are major investors in renewable energy generation.

Introduction

In its report, the Auditor-General cited the following rationale for conducting the audit:

“There is ongoing community, political and media interest in energy supply, particularly rising energy prices and their impact on Australian households and businesses. In regulating the energy sector, the AER makes decisions that can affect energy prices, security and reliability. The audit findings can provide lessons for more effective monitoring, reporting and enforcement of compliance with National Energy Laws, Rules and Regulations by the AER.”¹

The Energy Council agrees with this statement, and suggests that there should be broader consideration of the energy sector’s governance.

Discussion

Energy Market Governance has been considered a number of times since the National Electricity Market’s (“**NEM**’s”) inception in 1998.

In 2005 the current tripartite system of NEM governance was created, which was explicitly intended to separate rule making (via the Australian Energy Market Commission (“**AEMC**”)) from regulation and enforcement (through the Australian Energy Regulator (“**AER**”)) and market operation (the purview of the National Electricity Market Management Company (NEMMCo), since succeeded by the Australian Energy Market Operator (“**AEMO**”)). This separation was considered good practice, to provide maximum confidence to investors in the integrity of the rules. At the time the NEM

¹ p.27

governance structure was as set out in Figure 1, noting that the AER was (and still is) a subsidiary of the Australian Competition & Consumer Commission:

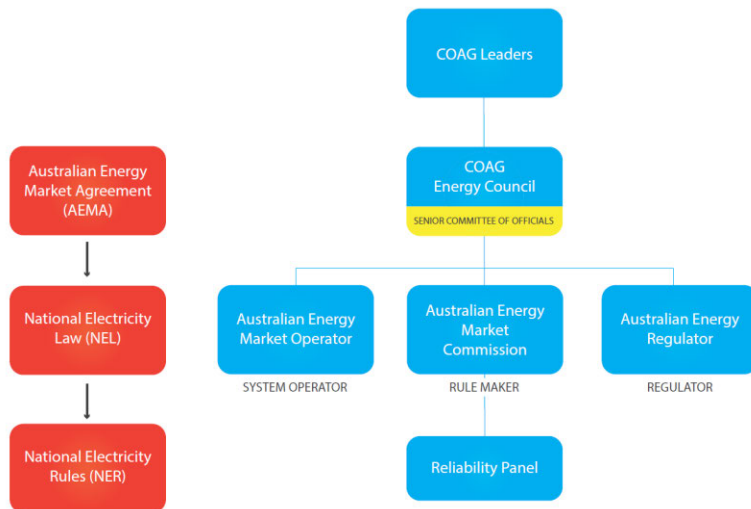


Figure 1: Old NEM Governance Framework
Source: Finkel Review,² Figure 7.2

In October 2015 the Final Report of the *Review of Governance Arrangements for Australian Energy Markets* (the “**Vertigan Review**”) was published.³ The report concluded that “the division of functions established by the current governance arrangements for Australian energy markets is fundamentally sound and ... amongst best practice internationally”.⁴

However it identified there was scope for improvement to adapt to the challenges of:

- the unprecedented pace of change in the energy sector; and
- the ‘strategic policy deficit’ – “which has led to diminished clarity and focus in roles, fragmentation and a diminished sense of common purpose”.⁵

It made 47 recommendations, 35 of which were agreed by the COAG Energy Council.

One of the recommendations was that “the Council issue an AEMO ‘statement of role’ which clearly specifies AEMO’s core role, and includes processes for accessing AEMO’s expertise in market and systems operations and the arrangements under which it is able to undertake other activities”.⁶

In January 2016 the COAG Energy Council agreed to this recommendation, and commissioned the Senior Committee of Officials to create AEMO’s Statement of Role in consultation with AEMO.⁷

Finkel Recommendations

In 2017 the Finkel Review⁸ did not form such a positive view on existing governance, presumably having observed division between the institutions. It recommended establishment of the Energy Security Board (“**ESB**”),⁹ which included each institution within its board, to have responsibility for the implementation of the report’s recommendations, and for providing whole-of-system oversight

² Finkel, A. et al., *Independent Review into the Future Security of the National Electricity Market: Blueprint for the Future*, June 2017

³ Vertigan, M. et al., *Review of Governance Arrangements for Australian Energy Markets – Final Report*, October 2017

⁴ ibid., p.7

⁵ ibid.

⁶ Recommendation 5.2

⁷ *Review of Governance Arrangements for Australian Energy Markets – Table of Responses*, p.8, available at

<http://www.coagenergycouncil.gov.au/publications/review-governance-arrangements-australian-energy-markets-final-report>

⁸ Finkel, A. et al., op. cit.

⁹ Recommendation 7.2

for energy security and reliability. As its justification, the report cited the establishment of the National Grid Management Council in 1991 to oversee and coordinate efforts in the transition to a national market.

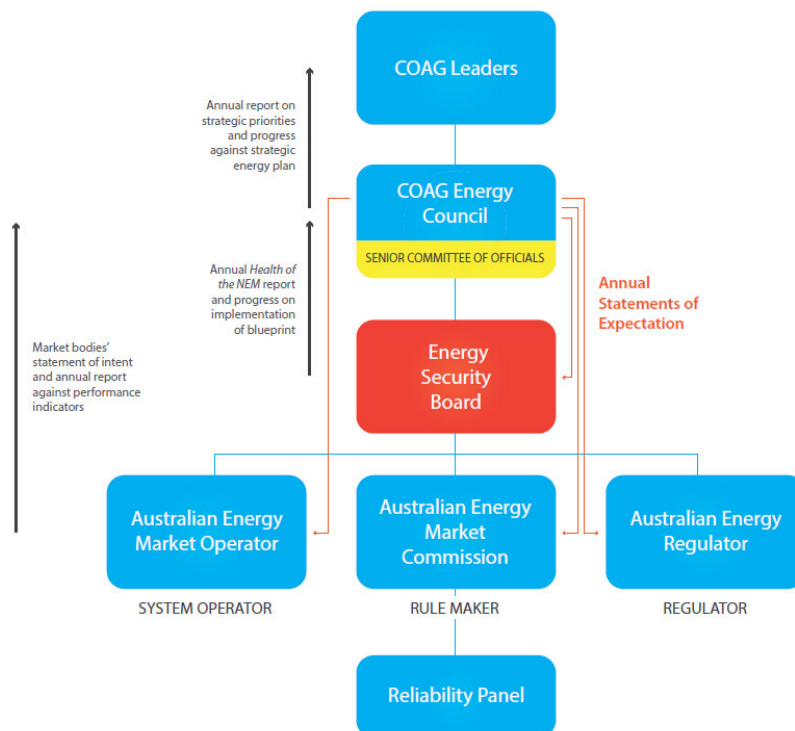


Figure 2: Current NEM Governance Framework
Source: Finkel Review Figure 7.3

The Finkel Review recommended that after a period of three years the COAG Energy Council should review the ESB's performance and future.

The ESB was duly established by the COAG Energy Council on 14th July 2017 for a three year term. In June 2020, an independent review of the ESB was published,¹⁰ which recommended that:

- the ESB should continue to December 2021 to complete the market design changes for the energy transition from conventional generation to a predominantly variable renewable energy generation future;
- at the cessation of the ESB, a Market Bodies Forum comprising the AEMC, AER and AEMO should be established;
- Energy Ministers should issue revised Statements of Expectations for the AEMC and AER, and a revised Statement of Role for AEMO; and
- the revised AEMO Statement of Role should address the issue of AEMO's role in the provision of policy or market development advice.

The review of the ESB therefore echoed the Finkel Review which, at Recommendation 7.5, said,

“By mid-2018, the COAG Energy Council, in consultation with the Energy Security Board, should issue new Statements of Expectations to the Australian Energy Regulator and the Australian Energy Market Commission, and a Statement of Role to the Australian Energy Market Operator containing a comprehensive set of outcomes-based performance indicators.”

¹⁰ Rhys Edwards RDME Consulting, *Review of Energy Security Board*, 24th June 2020

According to the 2018 *Health of the National Electricity Market* report (published on 20th December 2018), action on this Finkel Review recommendation was underway, and "The market bodies and the ESB have commenced a process to develop new Statements of Expectations and a Statements (*sic*) of Role for consideration by officials and COAG Energy Council."¹¹

The 2019 *Health of the National Electricity Market* report (published 24th February 2020) was not so explicit about progress against the Finkel Review governance recommendations. It reported Recommendation 7.5 as "Issue new Statements of Expectations to the AER and AEMC" (note the absence of a reference to AEMO), and summarised its status as "On track".¹²

The 2020 *Health of the National Electricity Market* report (published 5th January 2021) showed that Recommendation 7.5 (again omitting AEMO) is "On track", mentioning that the AER has adopted a five year strategic plan "centred on the COAG Energy Council Strategic Energy Plan", and noting that there are "pending updates of the Statement of Expectations ... of the market bodies".¹³

The CEPA Report

As alluded to in the Review of the ESB, the AEC and Energy Networks Australia ("**ENA**") identified, at a high-level, possible areas for improvement in market and system operator governance. To explore the topic, the parties commissioned Cambridge Economic Policy Associates ("**CEPA**") to prepare a report on *Governance and Regulation of Market/System Operators*. A copy is attached to this submission.

The report used a modified version of the Australian Institute of Company Directors' not-for-profit governance principles, being:

1. Roles and responsibilities: There is clarity about the roles, responsibilities and relationships of the board.
2. Board composition and appointment: The board's structure and composition enable it to fulfil its role effectively.
3. Purpose and strategy: The organisation has a clear purpose and a strategy which aligns its activities to its purpose.
4. Performance: The organisation uses its resources appropriately and evaluates its performance.
5. Transparency and accountability: The board demonstrates accountability by providing information to stakeholders about the organisation and its performance.
6. Stakeholder engagement: There is meaningful engagement of stakeholders and their interests are understood and considered by the board.

The report found that it is timely to review the existing governance framework, and that there is a case for reconsidering the strength of the accountability mechanisms that apply to AEMO, consistent with the level of scrutiny that is applied to system and market operators in other jurisdictions. The report concluded by recommending three possible prototype models for consideration.

The CEPA Report has been helpful in sparking discussion about AEMO's governance, as the Energy Council understands that AEMO has been considering the matter itself, but the Energy Council believes that the Commonwealth Government, as majority shareholder, has the responsibility, and obligation, to clarify the role of AEMO, a need which has repeatedly been called for by independent reviews.

¹¹ Energy Security Board, *The Health of the National Electricity Market 2018*, 20th December 2018, p.91

¹² Energy Security Board, *The Health of the National Electricity Market 2019*, 24th February 2020, p.52

¹³ Energy Security Board, *The Health of the National Electricity Market 2020*, 5th January 2021, p.65

The ESB and the Role of the Market Bodies

The creation of the ESB introduced a significant new dynamic into industry governance. Its chair and vice-chair have proven, despite the difficult political context, to be strong and pragmatic industry advocates, and the ESB has been given significant, challenging responsibilities, such as the development of a new post 2025 market design.

At the same time, the elevation of all three institutions to become members of the ESB has blurred the separation of roles that Vertigan sought to retain. It considers matters that would have previously been the preserve of the AEMC, yet the AER and AEMO effectively directly participate in that rule making. It is understood considerable policy division frequently occurs between the members.

Fortunately the Review of the Energy Security Board has recommended that it be disbanded when its current responsibilities have been progressed to a level sufficient for the separate institutions to take carriage of the ESB's initiatives. However the Review has proposed that a Market Bodies Forum be established in its place.

A Market Bodies Forum was originally established in June 2017, immediately before the appointment of the ESB. It had a rudimentary Charter¹⁴ and Interim (non-binding) Memorandum of Understanding,¹⁵ which was developed by the three bodies themselves. The Energy Council suggests that if such a Market Bodies Forum is to be re-established, more clarity regarding its operation should be given by the Government.

Conclusion

The Auditor-General's report into the AER highlighted that the AER is awaiting a statement of expectations from the Council of Australian Governments and the Treasurer.¹⁶ The Energy Council suggests that it is not just the AER which needs clarity of role; it is important for the other market bodies, the AEMC and AEMO, to have their responsibilities and obligations made clear by the Government. The Energy Council believes it would be valuable for the Committee to include these points in its recommendations.

Any questions about this submission should be addressed to the writer, by e-mail to

[REDACTED]

Yours faithfully,

[REDACTED]

Duncan MacKinnon
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¹⁴ Available at <https://www.aer.gov.au/system/files/Market%20Bodies%20Forum%20charter.pdf>

¹⁵ Available at <https://www.aer.gov.au/system/files/Market%20Bodies%20Forum%20-%20Memorandum%20of%20understanding.pdf>

¹⁶ p.43