

Select Committee on Energy Planning and Regulation in Australia

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## **Select Committee Inquiry – Institutional structures, governance, regulation, functions, and operation of the Australian energy market**

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Select Committee on Energy Planning and Regulation in Australia inquiry into the institutional structures, governance, regulation, functions, and operation of the Australian energy market.

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

### **Energy governance – background and previous reviews**

The key energy market governance bodies and their roles are set out in the Australian Energy Market Agreement (AEMA), which was amended most recently in December 2013. Energy Ministers have oversight of three key market bodies whose governance roles are intentionally separated:

- Australian Energy Market Commission – market design, rule changes;
- Australian Energy Regulator – economic regulation, market monitoring and compliance;
- Australian Energy Market Operator – market / system operation.

This separation represented best-practice governance, providing confidence for investors and consumers in the roles and responsibilities of each body.<sup>1</sup>

Energy market governance has been examined multiple times since 2013. In 2015, the Vertigan Review recommended retention of this structure with suggestions to expedite the rule change process and to clarify AEMO's role, particularly in market design. Vertigan found that:

*"Australia's energy market governance relies on clearly specified and stable policy and appropriate regulatory objectives, delegation of some roles to specialist institutions and importantly, institutional separation".*

Vertigan's recommendations were wide ranging, but their implementation was patchy. Vertigan made nine recommendations in relation to strategy setting and determining strategic priorities for energy market reform. The recommendations anticipated an active role for Senior Council Officials (SCO) in setting overall priorities for reform. Actual SCO practices have varied since then, with the creation of the ESB arguably supplanting the role of SCO for a period of time. To outside observers, following the cessation of the ESB, the role of the SCO appears to now be more akin to what was proposed in Vertigan.

Another Vertigan recommendation would have established constraints around jurisdictions derogating:

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<sup>1</sup> Vertigan, M. et al., *Review of Governance Arrangements for Australian Energy Markets – Final Report*, October 2015

*“That jurisdictions be permitted to implement derogations from otherwise nationally agreed agreements only if the derogation is targeted and time-limited and contains a commitment for re-evaluation against a ‘necessity principle’.”*

The actual experience with jurisdictional derogations has not been in line with Vertigan’s recommended approach. Vertigan also had detailed recommendations for each of the market bodies, pushing for greater transparency and efficiency for the AEMC, greater autonomy for the AER along with regular performance reviews by an independent panel of experts appointed by the COAG Energy Council, and a statement of role for AEMO. These recommendations remain valuable.

In 2017, the [Finkel Review](#) was concerned about institutional discord and reform slowness, and recommended the creation of the Energy Security Board (ESB), in which the heads of the institutions would sit alongside an independent chair and deputy chair. The ESB structure had the effect of elevating AEMO and the AER to equal status with the AEMC with respect to market design, in contrast to Vertigan’s recommendations on the importance of separation of institutions to support good governance. The AEC expressed its concerns about these aspects and recommended against an extension beyond the P2025 review in its submission to the Edwards review <sup>2</sup> which was considering the long-term role of the ESB.<sup>3</sup> Edwards recommended the ESB continue until the end of 2021 to complete the P2025 work, a recommendation accepted by Ministers. It also recommended disempowering S90F (rejected) and completing AEMO’s statement of role (agreed but not yet actioned).

The ESB has subsequently been replaced by the Energy Advisory Panel (EAP). The current iteration of energy market governance arrangements is overseen by the Energy and Climate Change Ministerial Council.<sup>4</sup>

In late [2020](#) and early [2021](#), the AEC and Energy Networks Australia jointly commissioned work into AEMO’s governance that recommended more industry or regulatory oversight of its activities and expenditure along with completion of the statement of role. This report led to AEMO convening a Financial Consultative Committee, to give industry and consumers greater oversight and input into AEMO’s financial governance. This committee is operating effectively and remains beneficial, however it could be enhanced through a more direct role in AEMO’s governance as a committee reporting directly to the Board. Consideration should also be given to funding an independent expert to interrogate AEMO’s costs to ensure they are prudent and efficient, similar to the way networks are regulated in the NEM.

### **Energy governance has shifted from market bodies to jurisdictions, with new institutions created**

In recent years, key energy policy decisions have increasingly come from outside market bodies, with both the Commonwealth and jurisdictional governments taking a more active role.

Jurisdictions have been actively involved with coordinating generation and transmission to help accelerate the energy transition and seek to do so at least cost to consumers. In NSW, EnergyCo was established to oversee planning for each Renewable Energy Zone (REZ). AEMO Services was established to oversee long term energy supply agreements (LTESAs) for renewable generation and storage.<sup>5</sup> In Victoria, VicGrid was established with a similar scope to EnergyCo. The State Electricity Commission was also reconstituted. In Queensland, the Queensland Energy and Jobs Plan plays a whole of energy system coordination role. At the Commonwealth level, DCCEEW has taken a much more active role. It has taken on streams of work formerly under control of the ESB, and the Government launched the Capacity Investment Scheme (CIS) to underwrite

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<sup>2</sup> [10 Mar 2021 - Review of the Energy Security Board | Energy Council - Trove \(nla.gov.au\)](#)

<sup>3</sup> <https://www.energycouncil.com.au/media/xhaemvg5/20200518-esb-review.pdf>

<sup>4</sup> <https://www.energy.gov.au/energy-and-climate-change-ministerial-council>

<sup>5</sup> LTESAs are options contracts which improve certainty for investors, and are offered in NSW to generation, storage and firming projects. They underwrite projects and seek to induce investment by reducing price uncertainty.

new renewable generation and storage which can be in place before 2030. AEMO Services, initially created to administer the NSW LTESAs has been appointed to run CIS tenders on behalf of the Commonwealth.

The AEC can understand the policy drivers behind these different reforms, and institutional changes. However, we observe that the creation of new institutions invariably carries with it the scope for confusion on their roles and accountabilities, a greater requirement on industry to engage with a wider variety of institutions, in turn increasing uncertainty in the energy sector and driving regulatory costs into the system. There is also the possibility of unintended consequences when Government intervenes in the normal market operations of the energy sector.

### **The Future Market Design of the National Electricity Market review**

At the Energy and Climate Change Ministerial Council meeting on 1 March 2024, Ministers agreed to take forward a review of the Future Market Design of the National Electricity Market: <sup>6</sup>

*“Ministers also noted an update on the process for taking forward a review of the Future Market Design of the National Electricity Market. Ministers agreed that the process for designing long term reforms to the wholesale market must be carried out expeditiously, building on the former ESB’s Post-2025 analysis that identified the need for capacity reforms, to bring forward certainty for investors. Ministers agreed the review will be initiated and terms of reference released by no later than April 2024, providing guidance on the direction of the future market design and a basis for launching stakeholder engagement. Ministers also committed to finalising the response to the review – including the final design of any capacity mechanism – by no later than the end of 2025, with senior officials to provide advice on the earliest possible timeframe.”*

Terms of reference for have not yet been released. It is important the market settings beyond the CIS are known to investors in a timely way, so we support the market review commencing as soon as practicable. To the extent the market review is conducted by the Productivity Commission, it is important that the coordination between the market review and the market bodies and senior officials is tightly managed. This is important not only as the terms of reference are developed, but during the review itself. This will guard against the risk that NEM reforms recommended are disconnected from jurisdictional reform appetite or not able to be implemented by market bodies as envisaged by the Productivity Commission.

### **The role for regulatory review**

Energy market reform involves decision making in an uncertain and evolving market. Despite the best of intentions and efforts of all involved, there can be unintended consequences of market reforms. There needs to be a streamlined, agile process for addressing any potential unforeseen or problematic consequences of reforms.

There also needs to be a structured approach to considering which reforms are likely to result in the greatest benefit to energy consumers. While this needs to be estimated upfront through cost benefits analysis conducted by market bodies, we think there is an important role that Post Implementation Reviews (PIRs) can play in critically assessing whether the benefits anticipated at the time for the decision eventuate. This assessment would also benefit from an expectation that reforms sunset after a set period, with the ability to easily extend rules and regulation where a PIR identifies net benefits. We recommend a positive obligation on the AEMC to conduct PIRs on major rule changes, as well as an expectation for new rules to sunset periodically.

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<sup>6</sup> <https://www.energy.gov.au/energy-and-climate-change-ministerial-council/meetings-and-communicues>

## **AEMO's Integrated System Plan (ISP)**

The ISP is a key document for market participants and Governments to cost effectively manage the energy transition for the benefit of consumers. Currently, AEMO must take the emissions reductions policies of Government as an input and derive an optimal development path consistent with achieving those policies. The ISP models what would need to happen to achieve the policy goals, but is often mis-interpreted as what will happen in practice. To bridge this gap, it is critical that AEMO 'book end' the scenarios by modelling its best estimate of how the future will turn out. Absent this, stakeholders and particularly consumers and governments do not have access to the best available information, which ultimately impacts the integrity of the ISP. AEMO has stated it is following the NER and this precludes it from modelling such a scenario. In our view this is incorrect because NER 5.22.2 states:

*"The purpose of the Integrated System Plan is to establish a whole of system plan for the efficient development of the power system that achieves power system needs for a planning horizon of at least 20 years to contribute to achieving the national electricity objective."*

We believe modelling an "efficient development of the power system" that satisfies the NEO requires a baseline scenario that is the best estimate from which other scenarios can be compared with. Given the scale, cost and pace of the energy transition, AEMO should include a scenario of what it thinks is likely and make this available to stakeholders and the public at large.

The 2026 ISP will include the role of gas and could benefit from a much greater emphasis on real world constraints and scenarios.<sup>7</sup> These constraints should be modelled across all generation technology types, not limited to a subset to avoid skewing the optimal development path.

Yours sincerely,

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<sup>7</sup> <https://www.energycouncil.com.au/media/4cnn3bzi/20240813-aec-sub-2025-iasr-final.pdf>