

8/03/2018

Dr Kerry Schott AO
Independent Chair
Energy Security Board

Lodged via email: info@esb.org.au

Dear Kerry,

National Energy Guarantee – Draft Design Consultation Paper

TransGrid welcomes the opportunity to respond to the Energy Security Board's draft design consultation paper in relation to the National Energy Guarantee.

TransGrid is the operator and manager of the high voltage transmission network connecting electricity generators, distributors and major end users in New South Wales and the Australian Capital Territory. TransGrid's network is also interconnected to Queensland and Victoria, and is instrumental to an electricity system that allows for interstate energy trading.

As recognised by the Energy Security Board, Australia is in the midst of an energy transformation. This is primarily driven by changing community expectations and choices, advances in renewable energy technologies, retirement of existing generation, and the adjustments required in Australia's economy to meet our international climate change commitments. These changes raise complex issues in relation to the design of the National Electricity Market (NEM) and have led to a greater focus on ensuring reliability of supply and where that supply comes from.

The NEM governance framework must adapt to these changes and provide the basis for low emissions, reliable supply at the lowest cost to consumers over the long run.

Our understanding of the National Energy Guarantee

TransGrid understands that the Guarantee has two elements which will require retailers to contract with, or directly invest in, generation, storage or demand response so that:

- There is a minimum amount of 'dispatchable' energy available to meet consumer and system needs when a gap is identified by the Australian Energy Market Operator (AEMO) (the reliability requirement).
- The average emissions level of the electricity that retailers sell to consumers supports Australia's international emission reduction commitments, as set by the Commonwealth Government (the emissions requirement).¹

The Energy Security Board has not provided a clear definition of what it would consider as dispatchable generation under the reliability requirement and therefore it is difficult to assess the full impact of this part of the Guarantee at this early stage.

As the transmission planner in New South Wales and the owner and operator of electricity infrastructure with long operating lives, TransGrid is interested in the development of the

¹ We note that the Energy Security Board also proposes that the guarantee applies to market customers as defined in the National Electricity Rules.

Guarantee as it is a significant reform in the electricity sector. Its implementation will have an impact TransGrid's customers (i.e. generators and large energy users) and the costs, and any benefits, will ultimately affect consumers.

We are also interested in the interaction of the Guarantee with the current and future work by other NEM governance bodies relating to reliability and security issues as we view the reliability and security of the electricity system as inherently linked.

The Guarantee needs to be developed with the Integrated System Plan

The Guarantee will need to be supported by and take account of the Integrated System Plan currently being prepared by AEMO which was a key recommendation from the Independent Review into the Future Security of the NEM (Finkel Review).

In a system with increasing levels of intermittent generation, more robust regional links and greater interconnection between states, the Integrated System Plan will be important in delivering the increased system reliability sought by the Guarantee. It is important that the transmission network does not become a bottleneck for electricity supply in the NEM.

In relation to the Integrated System Plan, we agree with the Energy Security Board that the treatment of interconnectors will be an important consideration for the design and implementation of the Guarantee.² Interconnectors are a cost-effective approach for integrating and aggregating a large share of variable renewable energy and maintaining energy security. The potential for interconnectors to meet reliability needs as an alternative to generation is also recognised by the regulatory investment test for transmission which assesses the costs and benefits of alternative options including network and non-network alternatives.

The Energy Security Board should also consider whether there is overlap with the Australian Energy Market Commission's (AEMC) review of coordination of generation and transmission investment which is looking at drivers that could impact on future transmission and generation investment. This review is not discussed by the Energy Security Board in the Energy Guarantee draft design consultation paper.

The design of the Guarantee should explicitly reflect desired policy outcomes

TransGrid supports a mechanism which aims to better align energy and climate change policy to drive emissions reductions while supporting reliability of the electricity system. However, there is insufficient information on the design at this stage to fully understand the market impacts of the Guarantee. We are also concerned about the short timeframe in which the Guarantee is being developed given its significance to the NEM and more broadly the importance of electricity to a well-functioning economy.

In contemplating the detailed design of the Guarantee, the Energy Security Board should consider the following principles:

- *Long-term policy certainty:* The Guarantee should provide long-term stability for producers and consumers of electricity. Policies to underpin the energy system transition must provide long term certainty that allows for bankable decisions by investors to ensure the orderly development of new generation capacity as required to meet energy demand as ageing thermal generators reach end of life, at the lowest cost for consumers. This certainty will help guide investment decisions by producers and guide consumers in making choices about their energy needs.
- *Increase liquidity and long-term price signals:* The Guarantee should not reduce the liquidity of the contract market. TransGrid is concerned that the current high-level design, which is based on a complex set of contracts linked to generation sources or emissions intensities, may lead to a fragmentation of the contract markets which may reduce liquidity in these markets. A more liquid market should lower the cost of trading or investing (through reduced volatility) and therefore this should be reflected in better long-term price outcomes for consumers.

² Energy Security Board, *National Energy Guarantee, Draft design consultation paper*, 15 February, 2018, p. 46.

- *Increase transparency of wholesale electricity prices:* Transparent prices are a characteristic of efficient markets - these are currently facilitated in the NEM through a gross pool market design. TransGrid is concerned that the Guarantee, as currently proposed, will result in a decrease in the transparency of wholesale market prices in the NEM as a result of an increase in the bilateral trading of contracts between generators and retailers (or internally in vertically integrated organisations).
- *Promote competition:* The Energy Security Board notes in its consultation paper that there is a risk of the Guarantee increasing the market power of incumbents, and that the detailed design should seek to avoid this. TransGrid agrees that the design should enhance competition and not further entrench existing market power or create barriers to entry for new market entrants. This includes considering the compliance burden, which may act as a largely fixed cost disproportionately impacting small generators and retailers.
- *Simplicity and cost effectiveness:* The Guarantee should be simple and easy to administer to minimise compliance costs. We note that the multi-step nature of the Guarantee (placing emissions and reliability obligations on retailers which must then be traced through to generation) is likely to require a significant amount of administrative costs on retailers and major energy users as well as monitoring and compliance costs by the Australian Energy Regulator. These costs are ultimately borne by consumers.
- *Flexibility:* Consistent with Australia's international commitments, a well-designed Guarantee should facilitate a progressive reduction in greenhouse gas emissions from the NEM and have the flexibility to allow for the adjustment of emissions targets over time.
- *Clear oversight:* We note that the Energy Security Board has proposed that the majority of the Guarantee be implemented through amendments to the Australian Energy Market Agreement, the National Electricity Law and the National Electricity Rules. A key benefit that the Board has identified is that the existing framework would enable refinement across time without large-scale reviews. TransGrid supports a governance approach which allows for ongoing refinement through consultation and avoids constant ongoing changes which would increase policy uncertainty.

Other important market reforms must be fully coordinated with the Guarantee with clear roles and oversight

The consultation paper notes a number of reforms related to the Energy Guarantee, including the interaction of the Guarantee with existing reliability and security work programs in Appendix B. TransGrid supports viewing the Guarantee as part of a broader set of industry reforms, but urges the Board to consider the full set of major reforms currently being considered across the NEM.

The Energy Security Board states that it will coordinate the consideration of strategic reserves, day-ahead markets and demand response by market bodies which will interact with the Guarantee.³ In addition, it states that it will manage the interaction of the various related reforms.⁴ However, TransGrid understands that the consideration of strategic reserves, day-ahead markets and demand response are the responsibility of the AEMC and AEMO, not the Energy Security Board.

We seek clarification on the role of the Energy Security Board and the other governance bodies on these important and interrelated issues. It will be imperative that the Board ensures that reforms are fully coordinated in their consideration, design and potential implementation as opposed to merely considered concurrently.

Next steps

Ongoing and meaningful consultation by the Energy Security Board will be critical to the success of the National Energy Guarantee.

³ Energy Security Board, *National Energy Guarantee, Draft design consultation paper*, 15 February, 2018, p. 50.

⁴ Ibid.

Although this is a short timeframe for public consultation, we appreciate the opportunity to comment on the draft high-level design of the Guarantee and look forward to continuing to engage with the Energy Security Board and other stakeholders on this and other market design changes. If you would like to discuss this submission, please contact Caroline Taylor, Manager/ Regulatory Policy on 02 9284 3715.

Yours faithfully



Anthony Meehan
Executive Manager, Regulation