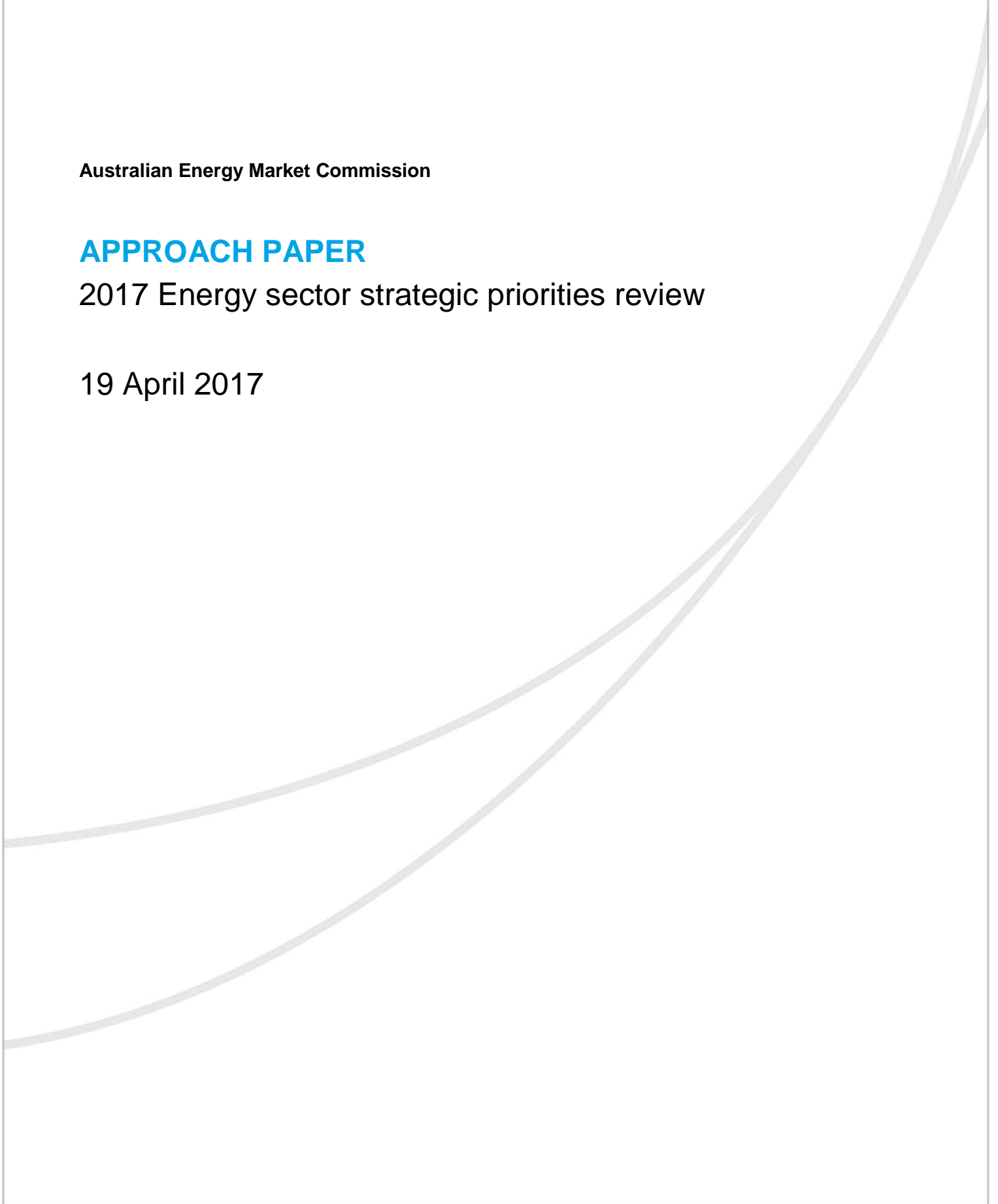


Australian Energy Market Commission

APPROACH PAPER

2017 Energy sector strategic priorities review

19 April 2017



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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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1 Introduction

The Australian energy markets are experiencing significant change making it critical for clear, focussed and consistent policy leadership. The COAG Energy Council (Council) is the appropriate forum to determine the strategic direction and priorities, and the work plans flowing out of these priorities.¹

In December 2016, the Council tasked the Australian Energy Market Commission (AEMC) with providing targeted strategic advice to inform the Council's strategy and priority setting process. Accordingly, the AEMC has commenced a review of the energy sector strategic priorities.

The AEMC received a terms of reference from the Council that require:

- the AEMC to deliver strategic advice, in the form of a report, to the COAG Energy Council secretariat by October 2017 and every three years thereafter
- that the advice is a broad, concise and high level analysis rather than a detailed examination of individual issues
- annual updates on the previous advice in between the triennial reports
- that in developing the advice, the AEMC must consult with the Standing Committee of Officials (SCO) and the energy market institutions (the Australian Energy Regulator, the Australian Energy Market Operator and Energy Consumers Australia)
- the AEMC to hold a workshop with the SCO to consider the strategic advice following delivery of each report.

The terms of reference have been provided as Attachment 1.

As required by the terms of reference, this paper sets out how the advice will be developed, including the process for consultation with stakeholders. It covers the:

- purpose and scope of the advice
- background to strategic priorities work
- approach to the review
- stakeholder consultation
- timeframes.

¹ COAG Energy Council, *COAG Energy Council response to the Review of Governance Arrangements for Australian Energy Markets - Table of responses*, 4 December 2015, p. 1.

2 Context and scope

Context

The energy sector is undergoing major change – technologically and economically. This is affecting how energy markets function. For example:

- Technological developments are changing the way electricity is generated, stored and consumed.
- The economics of the electricity sector are changing, creating challenges for existing participants and business models, at the same time as opportunities for new entrants and new business models are emerging.
- Gas markets have been affected by export volumes, international pricing and domestic exploration moratoria. These gas market dynamics have had consequent impacts on the electricity markets through the gas price effects felt by gas-fired generators and end users. Gas plays an important role in electricity generation as it supports the transition to newer, more distributed and intermittent forms of electricity generation.
- Consumer choices are expanding, providing increased options for engaged and active energy management.
- The speed of change is rapid, meaning challenges to and opportunities for the energy sector are emerging quickly and concurrently.
- Australia has made international commitments to reduce its carbon emissions.

In this context, to successfully meet the challenges and maximise the opportunities of the evolving energy sector for the long term interests of consumers, it is important that there is:

- clarity in the energy sector strategic policy direction
- a shared view of what needs to happen to achieve strategic policy goals
- a shared commitment to realising the goals.

Scope

The AEMC regularly performs strategic rule changes and reviews.² In addition to AEMC-led work, there are also currently a number of one-off reviews with a strategic focus occurring in the energy sector. Examples of current energy sector strategic reviews by other organisations include: the *Independent Review into the Future Security of*

² Examples of the AEMC's forward looking work includes the system security market frameworks review and the five minute settlement rule change.

the National Electricity Market (the 'Finkel review'), the Electricity Network Transformation Roadmap, and the Gas Vision 2050.

This strategic priorities review differs from other current strategic rule changes and reviews because it:

- involves a triennial in-depth assessment of energy market priorities with on-going annual monitoring and the ability to update the priorities where appropriate.
- is broader in scope compared with the forward-looking rule changes and reviews conducted by the AEMC which can be constrained by the nature of rule change requests and terms of reference.
- informs the COAG Energy Council on an ongoing basis providing a foundation for the COAG Energy Council to develop a co-ordinated and coherent policy agenda that will be adapted and varied in a timely manner.

The advice will highlight the key issues that could affect the COAG Energy Council's setting of strategic priorities in the Australian energy sector and energy markets. It will be a broad, high level analysis that sets out the significant current and potential challenges, risks and opportunities relating to the energy policy, regulatory or operational environment. The scope covers issues arising in all parts of the energy sector across the states and territories.³ It includes matters relating to electricity, natural gas and energy retailing.

³ Assessments of strategic priorities have traditionally focussed on energy sector issues specific to the eastern and southern states. However, many of these issues are likely to be common to Western Australia and the Northern Territory. Therefore energy sector issues in these jurisdictions will be canvassed in this review.

3 Background

In December 2014, the COAG Energy Council initiated a review on the governance arrangements in the Australian energy markets. The review panel released its final report in October 2015.⁴ The report's recommendations include that:

- the Council should determine the strategic direction of the energy sector and the associated work program to support this direction
- the SCO be responsible for presenting the Council with recommendations on strategic direction and a supporting work program
- the AEMC be responsible for aiding the development of this advice.

In December 2015, the COAG Energy Council's responded to the *Review of governance arrangements for the energy markets*. It recommended that the AEMC prepare a major policy paper every three years containing advice on market development strategy to inform the Council's priorities for the energy sector.⁵

Following that recommendation, the Council has formally requested advice from the AEMC on energy sector strategic priorities in December 2016. This work involves collaborating with the Australian Energy Market Operator, the Australian Energy Regulator and Energy Consumers Australia as well as undertaking broad stakeholder consultation.

The AEMC has a strong track record of developing and maintaining strategic priorities for energy market development. These past AEMC reviews were self-initiated and generally outlined the possible work program that could be undertaken by the AEMC to address identified issues in energy markets. The exception to this was the 2015 review, which suggested not only actions for the AEMC, but also those that the COAG Energy Council and the Australian Energy Regulator could undertake to deliver on the market priorities.

The AEMC initiated the first of three strategic priorities reviews in 2011. The priorities, published every two years, were developed in close consultation with community, business and government stakeholders. Further, the AEMC's 2016 work program identified key evolving strategic issues relating to the significant transitions occurring in the electricity and gas markets.

⁴ M Vertigan, G Yarrow and E Morton, *Review of Governance Arrangements for Australian Energy Markets - Final Report*, 23 October 2015, Canberra.

⁵ COAG Energy Council, *COAG Energy Council response to the Review of Governance Arrangements for Australian Energy Markets - Table of responses*, 4 December 2015, p 1.

The table below sets out the:

- priorities developed in each review of the strategic priorities for energy market development⁶
- priorities developed to guide the AEMC's 2016 work program⁷
- relevant market drivers for these priorities.

⁶ AEMC, *2011 Strategic priorities for energy market development*, 20 October 2011, Sydney; AEMC, *2013 Strategic priorities for energy market development*, 23 October 2013, Sydney; AEMC, *2015 Strategic priorities for energy market development*, 26 November 2015, Sydney.

⁷ AEMC, *Work program overview 2015/16*, 20 October 2016, Sydney.

Findings from earlier strategic priorities exercises

	2011 Strategic priorities for energy market development	2013 Strategic priorities for energy market development	2015 Strategic priorities for energy market development	2016 AEMC Work program overview
Priorities	<p>A predictable regulatory and market environment for rewarding economically efficient investment</p> <p>Building the capability and capturing the value of flexible demand</p> <p>Ensuring the regulation of transmission and distribution networks promotes timely investment and efficient outcomes</p> <p>Two key areas for continued consideration:</p> <p>The gas market and its interaction with the NEM</p> <p>Changing industry structure</p>	<p>Consumer priority – strengthening consumer participation and continuing to promote competitive retail markets</p> <p>Gas priority – promoting the development of efficient gas markets</p> <p>Market priority– supporting market arrangements that encourage efficient investment and flexibility</p>	<p>Consumer priority – enabling consumers to make informed decisions in competitive retail markets.</p> <p>Gas priority – promoting the development of efficient gas markets.</p> <p>Markets and network priority – market and network arrangements that encourage efficient investment and flexibility.</p>	<p>Integration of energy and emissions reduction policy</p> <p>More engaged and better informed energy consumers</p> <p>Promoting system security as market transforms</p> <p>Redesigning the east coast gas market to free up gas trading</p>
Drivers	<p>Forecast rising peak demand</p> <p>Carbon price policy uncertainty</p> <p>Large increases in retail prices caused primarily by network</p>	<p>Fall in demand growth</p> <p>Forecast rising peak demand</p> <p>Introduction of a carbon price</p>	<p>Forecast rising electricity consumption</p> <p>Forecast rising peak demand</p>	<p>Forecast flat electricity consumption</p> <p>Forecast rising peak demand</p>

	2011 Strategic priorities for energy market development	2013 Strategic priorities for energy market development	2015 Strategic priorities for energy market development	2016 AEMC Work program overview
	<p>costs followed by environmental policy costs</p> <p>Higher cost of capital since the GFC</p> <p>Risk of wholesale gas price rises as LNG terminals drive domestic prices to export price parity</p> <p>Increasing convergence of electricity and gas markets potentially creating new supply and security challenges</p> <p>Investment challenge to meet Renewable Energy Target (RET)</p> <p>RET expected to change generation mix, driving more volatile spot market outcomes</p>	<p>Large increases in retail prices caused primarily by network costs followed by environmental policy costs</p> <p>Average wholesale electricity prices close to the long-run costs of generation – workably competitive market</p> <p>Cautious capital markets – companies turning to vertical integration to manage risk.</p> <p>Upward pressure on gas prices due to tight supply/demand balance</p> <p>Retailers differentiating their service offerings through new technologies</p> <p>Increases in distributed generation</p> <p>New avenues for consumer participation in energy policy</p>	<p>Carbon price removed in 2014</p> <p>RET not integrating effectively with NEM.</p> <p>Changing generation mix – coal exiting, renewables entering; concerns for cost and system security and reliability</p> <p>First international shipment of LNG from Gladstone - domestic prices driving to export price parity</p> <p>Gas exploration and drilling moratoria</p> <p>Retail prices easing</p> <p>Retail competition more established and effective</p> <p>Retail electricity prices deregulated in NSW, SA, VIC, anticipated in QLD</p> <p>Consumers have greater choice and information – big data and digital enablement</p>	<p>Emissions policy uncertainty</p> <p>Changing generation mix – coal exiting, renewables entering; concerns for cost and system security and reliability</p> <p>Domestic gas prices driving to export price parity</p> <p>Upward pressure on retail prices</p> <p>Consumers more active in shopping around, changing the way they use electricity</p> <p>Growing range of technologies and services available to consumers</p>

This review will be different from previous AEMC-initiated strategic priorities reviews, particularly because it will provide broad strategic advice to the COAG Energy Council for its consideration, and include advice on how the priorities can best be achieved. Given the current strategic priorities review is wider in scope and will be endorsed by the COAG Energy Council, the priorities identified will articulate the actions needed to be undertaken by a much wider range of stakeholders, including the SCO, energy market institutions and market participants.⁸

The table highlights that overall the AEMC's earlier strategic priorities work and 2016 work program overview has consistently identified the:

- challenges posed by changing generation mix for system security and financial resilience of energy markets
- importance of integrating energy and emissions policy
- need for predictable policy to underpin future investment in generation
- ways to enable energy consumers to make informed choices, focusing on protection, participation and engagement – allow consumers to benefit from innovations and enhanced competition
- need for gas market reform so Australia has well-functioning gas markets as the LNG export industry ramps up.

The fact that these, or related matters are still identified by stakeholders as areas of concerns indicates that the challenge is not so much in identifying the issues influencing the energy sector. It is more in gaining agreement to the required solutions, allocating responsibility and having all parties commit to taking the required actions. This also needs to acknowledge and reflect any wider circumstances that affect the solutions and actions. A broad acceptance and understanding of the relevance and importance strategic priorities and a shared sense of purpose would provide the foundation for appropriate action.

⁸ Recommended actions to promote outcomes in the long-term interests of consumers could involve for example energy market participants, energy market institutions and consumers. It is for this reason that the AEMC has placed significant emphasis on stakeholder consultation in identifying the relevant issues, as discussed in section 5.

4 Approach

The energy sector strategic priorities review process will comprise of:

- scoping, information gathering, and initial conversations with stakeholders
- the development of a discussion paper
- formal stakeholder consultation on the discussion paper
- the development of the final advice
- delivery of the final advice to the COAG Energy Council
- the publication of final advice.

Timeframes for the review process are set out in section 6.

Approach to the discussion paper

The development of the discussion paper will draw widely from existing work and consultation processes in the energy sector to avoid duplication of effort.

Sources of information for the paper will include:

- information and data available from community, business and government stakeholders and the energy market institutions
- the work currently being undertaken in the 30 or more rule changes and reviews by the AEMC⁹
- the current one-off reviews, such as the *Independent Review into the Security of the NEM* (the 'Finkel' Review)¹⁰ which is in its final stages, and the Federal Government's review of climate change policies¹¹ which has commenced
- relevant parliamentary inquiries
- international studies and experience.

It is important to understand the context in which the development of the strategic priorities is occurring. To provide this context, the discussion paper will summarise the milestone developments in the Australian energy market. It will describe the key factors that have been and are driving the market over time.

⁹ Australian Energy Market Commission, viewed 19 April 2017, <http://www.aemc.gov.au/About-Us/Resources/Current-work/>

¹⁰ Department of the Environment and Energy, Australian Government, viewed 27 March 2017, <http://www.environment.gov.au/energy/national-electricity-market-review>

¹¹ Department of the Environment and Energy, Australian Government, viewed 27 March 2017, <http://www.environment.gov.au/climate-change/review-climate-change-policies>

The discussion paper will ask the question of how the market can achieve the future vision or goal. To do this, “strategy” will be defined as accommodating a planned series of actions directed towards addressing identified issues and achieving the desired goals. Strategic priorities will therefore refer to those priority areas where planned actions are most needed to ensure energy sector participants can achieve the articulated goals.

A critical part of the task is to provide a perspective on the timing of the emergence or management of issues. The discussion paper will distinguish between issues that emerge and can be managed in the short, medium and longer terms.

In summary, the discussion paper will:

- describe the milestone developments in the energy market
- identify the key factors influencing the market
- articulate the longer term goals for the energy sector
- identify the work-programs and actions required to achieve those goals
- describe the criteria and metrics to enable progress and success to be understood and measured.

As discussed above and in section 5, stakeholder engagement is a key component of this review process. The AEMC recognises that stakeholders are currently involved in several public consultation processes. Our process is intended to reduce stakeholder burden.

Approach to the final advice

The final report will draw from the discussion paper and associated consultation. It is intended to be a unifying document pulls together the outcomes of energy sector programs, reviews and projects into a strategic framework that reflects stakeholders’ views. The main features of the final strategic priorities advice are that it will:

- be informed by stakeholder feedback from initial conversations, other related consultation processes and formal consultation on the discussion paper
- contain energy sector strategic priorities for short, medium and long-term timeframes, the duration of which will be determined in the course of the consultation
- contain actions and responsibilities related to each strategic priority
- describe the expected outcome or result linked to the proposed actions.

Evaluating the energy sector strategic priorities

As discussed in section 1, the COAG Energy Council has an essential leadership role in defining a set of focussed priorities for the energy sector and its participants. In addition, it is also the body that will determine whether the strategic priorities will be successfully achieved.

A critical aspect of successful strategy execution is that there are consistent messages and actions from the leaders of the strategy. The Council's leadership role therefore requires it to practically demonstrate its commitment to achieving strategic policy goals through its actions and decisions. The SCO and energy market institutions also have a responsibility to work together to implement the strategic priorities. This would ideally be reflected in a national work programme that is published and has metrics that are reported against.

There are circumstances that can lead to jurisdictional differences in how a national work program would be applied. Differences across jurisdictions should be accommodated where necessary, but these differences need to be:

- specifically acknowledged
- limited in number and scope
- based on clear and assessable rationale
- regularly assessed for effectiveness, and
- wherever possible removed in favour of national approaches.

The AEMC considers that the annual updates that occur in between the triennial reports would be the appropriate mechanism to evaluate progress on the energy sector strategic priorities.

5 Stakeholder engagement

The terms of reference specify that the AEMC must consult with the SCO on an ongoing basis throughout the project. Importantly, it also requires the AEMC to consult with the other energy market institutions, which are the Australian Energy Regulator, the Australian Energy Market Operator and Energy Consumers Australia. Consultation with the market institutions will include ongoing bilateral meetings, and a proposed workshop. This workshop will occur prior to the SCO workshop that is scheduled for late-October under the terms of reference.

The AEMC views stakeholder engagement as a crucial part of the review. Therefore in addition to the mandatory consultation, a wide range of stakeholder engagement activities are planned to occur throughout project. These include bilateral meetings, AEMC participation in events held by stakeholders and public forums. As noted above, existing consultation exercises will be leveraged wherever possible to reduce stakeholder effort.

The AEMC considers a potentially useful starting point for discussions with stakeholders are the four issues identified in the 2016 AEMC work program overview. This does not in any way preclude other issues from being identified or prioritised, and the final strategic priorities will be informed by analysis and stakeholder feedback, as discussed in section 4.

The issues identified in the 2016 work program are:

- integration of energy and emissions reduction policy
- more engaged and better informed energy consumers
- promoting system security as market transforms to new technologies and renewables
- gas market reform.

The AEMC has in its submission to the Finkel review also highlighted that these issues can be addressed or enabled through promoting investor confidence and good governance in the sector.¹²

The main consultation will occur in August and September after the release of the discussion paper in August and September. Responses to the discussion paper will be gathered through conversations, events and formal submissions. It is an opportunity for stakeholders to provide comments and feedback on the discussion paper for the public record. Stakeholder feedback will inform the final advice to the COAG Energy Council.

¹² Australian Energy Market Commission, viewed 19 April 2017, <http://www.aemc.gov.au/News-Center/What-s-New/Announcements/AEMC-submission-to-the-independent-review-on-the-f>.

The Commission sees this review as an opportunity to discuss issues with and hear views from a broader range of stakeholders than would ordinarily be involved in the AEMC's work. This is because the scope of the review is broad compared to the scope and process constraints of usual rule changes and reviews.

Although we are not seeking formal stakeholder submissions on this approach paper, we welcome comments on our approach to the review. Comments can be provided by contacting Emily Brodie by Friday 12 May 2017 (contact details below).

6 Timelines

Scoping, information gathering, initial conversations with stakeholders	March to July 2017
Discussion paper	August 2017
Consultation on discussion paper and other stakeholder engagement activities	August to September 2017
Final advice delivered to COAG Energy Council	October 2017
Publication of final advice	November 2017

For information contact:

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AEMC Senior Adviser **Emily Brodie** (02) 8296 7818 or emily.brodie@aemc.gov.au

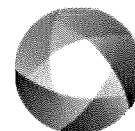
A Terms of reference

Project ID

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**COAG
Energy Council**

Chair

Mr John Pierce
Chair
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce *John*

You would be aware that in December 2015, in response to the *Review of Governance Arrangements for Australian Energy Markets*, the Council of Australian Governments (COAG) Energy Council (the Council) agreed to task the Australian Energy Market Commission (AEMC) with providing targeted strategic advice to inform the Council's energy market strategy and priority setting.

I want to thank you for your considered engagement since that time and for your suggestions to amend the national energy laws in relation to this important strategic advice role. As the Council has resolved to rely on the existing national energy law framework, rather than make further legislative amendments, the attached Terms of Reference has been developed with the aim of formalising the provision of this advice.

The Council is seeking a report that informs key issues that could impact on its efforts in determining and setting strategic priorities in the Australian energy sector and markets. The report is intended to be a brief, broad, and high-level analysis of issues drawing on the AEMC's daily experience of the sector and its institutional interactions. It will form an important contribution to Council deliberations in the coming years, and it is intended that the outcome of those deliberations will be published on the Council website as a means of providing guidance to the energy community and its institutions, including the AEMC. Importantly, as this tasking is an ongoing triennial process, each advice and subsequent response of the Council is intended to build upon the former, with the aim of providing a body of work to assist decision makers into the future – it will act as a transparent reflection of the evolution of the Council's priorities over time.

If you require further information please contact Mr Brenton Philp, A/g First Assistant Secretary, Energy Division on (02) 6275 9026.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'Josh Frydenberg'.

The Hon Josh Frydenberg MP
Chair
COAG Energy Council

December 16

Terms of Reference

Request for advice: Energy Sector Strategic Priorities

Context

On 4 December 2015, the COAG Energy Council (the Council) published its response to the *Review of Governance Arrangements for the Australian Energy Markets* (the Review). In its response, the Council affirmed that it is the primary entity responsible for setting strategic direction in the energy sector and in relation to energy market reform. Critical to this is the identification of emerging circumstances (or the potential for such circumstances) that could transform the energy sector. The Council's role is to provide leadership and strategic guidance about how such structural changes should, if at all, be accommodated within the national energy frameworks.

To assist in the Council's understanding of the changing environment in and around the energy sector, and ultimately in determining strategic priorities, it is necessary to seek advice from a range of expert sources. An important part of this is to draw on the Australian Energy Market Commission (AEMC), and its understanding of the detailed frameworks set out in the national energy rules, to highlight major issues currently facing the energy market and circumstances that could arise in the in the future that may require further analysis.

Energy Council Directed Review

The Council comprises Ministers responsible for Energy matters. These Ministers comprise the membership of the legally enduring Ministerial Council on Energy (MCE). Pursuant to section 6(b) of the *Australian Energy Market Commission Establishment Act 2015*, the MCE requests the AEMC to provide advice on current and future challenges and opportunities facing Australia's energy sector and energy markets.

This Terms of Reference (ToR) is an ongoing tasking of the AEMC. Future advices are intended to build on previous work to provide a useful body of work against which current strategic priorities may be referenced.

Content of the Report

The Council seeks a report that sets out the key issues that could impact on the Council's efforts in determining and setting strategic priorities in the Australian energy sector and Australian energy markets. Broadly, the report should cover significant current and potential challenges, risks and opportunities relating to the energy policy, regulatory or operational environment.

It is intended that this advice be a broad, high-level analysis rather than a detailed examination of individual issues. More specifically, the report should concisely highlight:

- major challenges, risks and opportunities currently facing the energy sector and energy markets;
- any current or potential future energy sector related developments that could impact on the national energy regulatory frameworks and their capacity to deliver:

- the statutory objectives articulated in the NEL, NGL and NERL;
- the objectives articulated by COAG in the Australian Energy Markets Agreement;
- the current work being progressed by the AEMC, inclusive of reviews and rule change requests, that are relevant to the matters listed above;
- from a high-level, issues-based perspective, matters covered under the national energy rules that may require further consideration.

The advice should be developed in the context of any matters that could impact on national energy policy, including the delivery of the National Electricity Objective, the National Gas Objective and the National Energy Retail Objective.

Process and deliverables

The AEMC will provide its detailed advice, in the form of a report to the MCE by October every three years. In the intervening years, the AEMC is to annually provide updates on its previous detailed advice to the MCE by October. Unless determined otherwise, the Report will be published in mid-December following the provision of advice to the MCE in October.

In addition to its existing consultation activities, in developing the advice and the updates, the AEMC must consult with:

- the Standing Committee of Officials (SCO) on an ongoing basis; and
- the other market institutions (the Australian Energy Regulator, Australian Energy Market Operator and Energy Consumers Australia).

The process is expected to take about one year from commencement of the work until the consideration of the advice by the COAG Energy Council. A timeline for the provision of advice is set out below:

Activity	Due by
Terms of Reference issued to the AEMC	The second half of year 1 (initially 2016).
Development of detailed approach	December – year 1 (and in December each year before the next advice is to be provided).
Delivery of advice to Council Secretariat	September/October – year 2 (initially 2017, and every three years thereafter).
Workshop with SCO; consideration of advice	Late-October – in each year following receipt of the advice.
COAG Energy Council publishes its strategic priorities	December – in each year following receipt of the advice.

The full process for developing the detailed advice will be conducted every three years. In line with this, it is expected that the AEMC will provide detailed advice in October 2017, 2020, 2023, etc.

The AEMC must publish a statement of approach setting out how the advice will be developed, including the process for consultation with all stakeholders.

Future variations to the Terms of Reference

As with all advice requested by the MCE, the Council recognises it may be necessary to vary this ToR to reflect changing priorities, experiences over time with the type or frequency of advice or, if necessary, to terminate this request for advice. Additionally, supplementary ToR for future triennial reviews may be issued to focus upon specific areas of national policy interest.