



THE HON JOSH FRYDENBERG MP
MINISTER FOR THE ENVIRONMENT AND ENERGY

MS18-000666

Mr John Pierce AO
Chair
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr *John*
Pierce

The Australian Government supports the rule change request from the Energy Security Board proposing that generators be required to give a minimum three years' notice of closure, a recommendation of the Finkel Review.

Notice of closure will help industry, governments, the Australian Energy Market Operator and other parties achieve the objectives of security, reliability and affordability, by giving the market appropriate notice to respond when generation is exiting the market.

Obligations to provide notice of closure must be backed by penalties for non-compliance. Given the importance of this information for planning to achieve security and reliability and to avoid price shocks, breaches of the new provisions in the rules should attract strong civil penalties.

I have enclosed responses to some of the questions posed in the Australian Energy Market Commission's (AEMC's) consultation paper.

The security, reliability and affordability of energy are priorities for the Australian Government, and I look forward to the AEMC's timely consideration of this rule change request.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Josh Frydenberg', written over a horizontal line.

JOSH FRYDENBERG

Enc

Amendment (Generator three year notice of closure) Rule 2018

Consultation question responses

Question 1: What problems are caused by generators providing short notice of closure?

The problems caused by short notice of generator closure include unnecessary costs imposed on consumers, and risks to achieving security and reliability objectives.

The Finkel Review noted that while the energy-only market design in the National Electricity Market (NEM) provides price signals for the entry of new generation capacity, in practice generators can retire with much shorter notice than the time taken to build new capacity¹.

Investors receive signals about the need for new generation capacity from both real-time prices in the wholesale market, and future prices in contract markets. To avoid imposing unnecessary costs on consumers, it is preferable that future prices are based on the best possible information about expected supply-demand balances, including expected closures. Otherwise, rapid closures result in higher prices that can't be avoided until new capacity enters the market.

This has been demonstrated since the closure of the Hazelwood power station in March 2017. The AER has found that the closure of Hazelwood resulted in significantly higher wholesale market prices as black coal and gas generators increased output to replace the lost capacity². Some of these additional costs may have been avoided had the market had better information about the closure, and more time to invest in lower-cost replacement capacity.

Rapid closures also increase the risk that reliability or security objectives may not be met. This was seen in the Australian Energy Market Operator's (AEMO) efforts to prepare for summer 2017-18. In the June 2017 Energy Supply Outlook, AEMO identified a heightened risk of summer supply disruptions, in part due to the rapid closure of Hazelwood³. To prepare for summer 2017-18, AEMO undertook extensive preparations, including working with industry to return capacity to the market, re-scheduling maintenance and outages, and procuring capacity through the Reliability and Emergency Reserve Trader (RERT) mechanism.

These efforts were effective, with no reliability interruptions to NEM customers during the summer. However, the need for enhanced summer preparations, and the costs involved, may have been avoided with sufficient notice of generator closure, which would have enabled the industry to take steps to replace this capacity in a timelier manner.

Question 2(a): Through which processes should participants notify AEMO of their closure intentions?

The Australian Government does not have a view on the specific mechanisms through which AEMO should be informed of closure intentions.

However, mechanisms should meet the objective that information provided is transparent and costs to participants are minimised.

Question 3(a): Does a three year minimum notice strike the right balance between providing investors with enough notice and generators enough decision making flexibility?

¹ *Independent Review into the Future Security of the National Electricity Market: Blueprint for the Future*, Commonwealth of Australia 2017, p.87.

² AER (2018) *AER electric wholesale performance reporting – Hazelwood advice*, p.1.

³ AEMO (2017) *Summer Operations 2017-18*, p.1.

The notification period needs to provide sufficient time to build replacement capacity or implement other responses to a generator withdrawal.

Following public consultations, the Finkel Review recommended three years as an appropriate notice period.

Question 4: What size threshold should apply to the requirement to notify AEMO of closure?

The threshold proposed in the consultation paper is appropriate, that is, scheduled and semi-scheduled generators 30 MW and above.

Generators are required to be scheduled or semi-scheduled because they are large enough to have a significant impact on the security and reliability of the electricity system and on outcomes in the wholesale market.

Since rapid retirement of scheduled and semi-scheduled generators may have similar impacts, a minimum notification period for closure of these generators is appropriate.

Question 6(a): Should a civil penalty apply in relation to the proposed changes?

Civil penalties should apply in relation to the proposed changes, in particular the requirements to:

- provide accurate information about expected closure dates
- maintain information about expected closure dates
- provide three years' notice of closure intentions.

Civil penalties should apply where there is the potential for significant detriment to consumers, the operation of the market or the operation of the electricity system arising from a breach of a provision.

Given the potential for detriment from rapid retirement of generation, civil penalties are appropriate for breaches of these new provisions.

Parties should not be able to avoid civil penalties by ceasing operations. Rule 2.10.2(c) of the National Electricity Rule provides that a person cannot avoid liabilities incurred under the Rules prior to ceasing registration. The AEMC should ensure that these provisions extend to the new requirements for notification of closures.

Question 6(b): Is it appropriate to provide exceptions to the requirement for a generator to provide three years' notice in response to unforeseeable events beyond the reasonable control of the generator?

Parties should not be penalised for events that are genuinely beyond their control.

However, it will be important to tightly define exceptions to prevent manipulation or gaming. Additional provisions could be added similar to the rebidding civil penalty provision (r. 3.8.22A), such that information about closure dates, including closure notifications, must not be false, misleading or likely to mislead.

Breaches of these requirements should be subject to a civil penalty, with the AER using its powers to investigate a potential breach.

Question 6(c): What guidance should be provided in the NER about what 'closure' means?

AEMO's work to prepare for summer 2017-18 demonstrated that capacity that is notionally unavailable to the market can return to service given appropriate incentives. The market provided 833 MW of additional capacity from mothballed gas generation, and AEMO worked with industry to improve the availability of other existing generation⁴.

The normal understanding of the term 'closure' should be used in the context of this rule change, that is, capacity that will be entirely withdrawn from the market and not able to return in the event of market changes, directions from AEMO or other circumstances.

It will be important to ensure that generators cannot circumvent the three-year notice requirement by announcing a closure and mothballing a plant shortly thereafter.

⁴ AEMO (2018) *Summer 2017-18 operations review*, p.4.