



27 September 2017

Mr John Pierce
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FROM THE OFFICE OF THE
CHIEF EXECUTIVE OFFICER

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Dear Mr Pierce

Strategic Priorities for the Australian Energy Sector – Discussion Paper

As independent gas and electricity system and market operator, AEMO welcomes this assessment by the AEMC, and thank the AEMC for the opportunity to engage in this process.

The Australian energy sector, perhaps more at present than ever before, requires earnest and urgent consideration of how to address and prioritise current challenges and how best to achieve improved policy outcomes for Australian energy customers. Consistent with the COAG Energy Council's recent adoption of the Finkel review recommendations, the tremendous changes we are witnessing in the power system require that we take urgent and deliberate action to ensure the system remains reliable, secure and allows consumers to gain value from the energy system.

AEMO considers that the recently formed Energy Security Board (ESB) provides a solid foundation for the energy market institutions to work together and consider how best to enhance market arrangements to ensure an orderly transition is achieved for energy customers.

Markets in Transition

In our recent advice to Commonwealth (4 September 2017), we highlighted that alike others around the world, Australia's energy system is undergoing an unprecedented transformation. Changes include progressive retirement of an aging traditional power generation fleet, flattening demand growth, increased prices in domestic gas due to international LNG markets, rapid growth of variable renewable energy resources, increased penetration of rooftop solar, advances in storage capability and the ability to access and exploit increasingly large amounts of data. All these are radically changing the dynamics of the power system.

The recent adoption by the COAG Energy Council of the Finkel review recommendations, has provided a clear blueprint to support an orderly transition to a clean, secure, reliable and affordable future for energy customers. AEMO agrees with the AEMC that strategic priorities set out for discussion should be an input to the ESB as part of consideration for the COAG Energy Council on the strategic energy plan for work in 2018.

The priorities, and related outcomes, are by their very nature interwoven. As system and market operator for the National Electricity Market (NEM), AEMO is managing on a real-time basis the impacts associated with a changing generation mix, new and innovative emerging technologies, shifting customer demand in response to technologies and price, and the integrated nature of the gas and electricity markets (both domestic and abroad).

The scale of changes we are witnessing in the power system require that we take urgent and deliberate action to ensure the system remains reliable, secure and allows consumers to gain value

from the energy system. In order to deliver these outcomes, particularly with the sector continuing to transition, it is important that market arrangements can operate to provide the right incentives to deliver reliability and reserve requirements.

Prioritising reviews of market arrangements to ensure incentives to deliver security and reliability remain fit for purpose should be a strategic priority for the energy markets.

Reliability and Reserve

Like power system security, reliability is a key service to the system and involves a range of resources provided across planning and operational timeframes, using a range of technologies at different locations.

As market operator, our role is to dispatch resources in the order in which they meet demand at the most economical price. This requires system optimisation. Historically, energy price signals have addressed this requirement because of the nature of the resources at the markets disposal. However, as the nature of those resources changes, it will be important to ensure market signals can be revealed and their ability to deliver the right resources to provide the services needed.

Different types of resources and requirements are needed to meet demand: fast responding, slow responding, contingency reserves and black start reserves. Specifying these requirements becomes more critical now that resources that do not inherently provide the services have entered the market. Optimal outcomes will be delivered when prices accurately value a resource that delivers security and reliability to the system.

While historically these services have been delivered with supply side solutions, there is now much greater opportunity to engage price responsive demand to deliver equivalent services. Changes to market arrangements to enable enhanced signals for reliability and security will ensure greater optimisation of systems. This will, in turn, support greater affordability for energy customers.

Efforts to facilitate the increased integration of price responsive demand should therefore be a key strategic priority for the energy markets, consistent with the Finkel review outcomes.

Next steps

I look forward to continuing our work together, and with the AER as members of the ESB, to drive the strategic direction of the energy markets.

If you have any questions, please contact my EGM, Centre for Innovation, Jo Witters, on jo.witters@aemo.com.au or (03) 9609 8496.

Yours sincerely



Audrey Zibelman
Managing Director and Chief Executive Officer