



11 February 2021

Ms Anna Collyer
Chair
Australian Energy Market Commission

Lodged via the AEMC website

Dear Ms Collyer,

ERC0295: RESERVE SERVICES IN THE NATIONAL ELECTRICITY MARKET DIRECTIONS PAPER

The Clean Energy Council (CEC) is the peak body for the clean energy industry in Australia. We represent and work with hundreds of leading businesses operating in renewable energy and energy storage along with more than 7,000 solar and battery installers. We are committed to accelerating the transformation of Australia's energy system to one that is smarter and cleaner.

The CEC welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC's) directions paper in relation to reserve services in the National Electricity Market (NEM). We appreciate that the AEMC has taken this additional step to produce a directions paper rather than progress to a draft determination. Our submission makes some high-level comments to assist the AEMC's thinking as it develops its draft determination.

Please note that due to the timing of this consultation in relation to Christmas shutdowns for the CEC and many of our member companies and the large number of open consultations at this time across the market bodies our comments below may not be an exhaustive list of industry's questions and concerns.

Reliability vs. security

The transformation of the NEM has led to a heightened interest in whether the existing market frameworks are appropriate for a future energy system with a higher penetration of renewables. In this context, operating reserves have been discussed both in relation to a reliability need and security need.

In the CEC's October 2020 response to the Energy Security Board's (ESB's) post-2025 market design consultation paper, we provided support for a more detailed exploration of an operating reserve mechanism under the resource adequacy mechanism market design initiative. An operating reserve could support reliability objectives by sharpening price signals to ensure resource adequacy in operational timeframes.

Since then, the ESB's post-2025 market design directions paper released in January 2021 notes that the ESB will continue to explore the development of an operating reserve through the essential system services workstream. Simultaneously, the directions paper notes that the ESB will continue to explore options to enhance the Retailer Reliability Obligation (RRO) as a mechanism to support reliability objectives.

Whilst it has always been acknowledged that an operating reserve could support reliability and security needs, the discourse now appears to emphasise the security objective over the reliability objective. An operating reserves' ability to address reliability needs should not be forgotten. As such, the CEC considers more thought should be given in this consultation to the potential for the reserve mechanism to operate as a resource adequacy mechanism. It is important that this consultation be integrated with the ESB's work on resource adequacy mechanisms, rather than proceed separately as appears to be the case. The AEMC's decision on an operating reserve should not pre-empt the ESB's final recommendations on resource adequacy mechanisms as part of its broader post-2025 market design package of reforms. The CEC cautions that implementing an operating reserve together with an expanded RRO may be an overly conservative approach that could result in a significant regulatory and compliance burden on industry and the potential to create mixed investment signals for new resources.

Providing incentives for new resources

The AEMC's consideration of an operating reserve should look to ensure a design that promotes an orderly, least cost and no-regrets transition to a decarbonised energy system. An operating reserve should incentivise new capacity investment to efficiently replace ageing generation plant and lower emissions while maintaining grid reliability and security. This design should encourage not only new fast response and flexible assets, but also slower responding demand-side resources.

To this effect, the CEC does not support option four for a ramping commitment service as this appears to favour legacy thermal generation assets. This option does not appear sustainable as it would not support the requirements of a future energy system.

Design options

The CEC has not landed on favouring one option over the other at this stage. This is in part due to the limited detail in the consultation paper around how the options would operate in practice and the complexity around determining the commercial implications for participants.

The CEC sees merit in further exploration of option one – a co-optimised operating reserve market – and option three – a callable operating reserve market. We understand that co-optimisation of energy and reserves is considered best practice in international markets. The co-optimisation of energy and reserves (much like ancillary services and energy) would result in the energy price reflecting the opportunity cost of providing reserves (and the other way around) in real time, thus ensuring reserve and energy prices remain consistent.

As a principle therefore, the CEC prefers co-optimised market design where possible. However, we acknowledge that approaches, such as option three, that remove capacity from being able to bid into the energy or frequency control ancillary services (FCAS) markets may have a greater impact than those that do not remove capacity from being available and instead are co-optimised, as would be the

case with option one. Our preference is also that the operating reserve arrangements are set in such a way to maximise participation, particularly from new entrants. We are conscious that option one's requirement that reserve providers need to be market participants may act as a disincentive to participate for some potential providers, such as certain demand response.

In preparing the draft determination and presenting a preferred option, we suggest the AEMC should provide a detailed exploration of the relative merits and trade-offs associated with these two options. It would also be worth developing worked examples for the two options, including a description and analysis of their interaction with the existing energy and FCAS markets. This should consider any potential implications of an operating reserve on wholesale energy prices. There are strong price signals for investment associated with energy prices and it may be possible that an operating reserve may reduce the volatility in wholesale prices. This could be balanced out by the volatility instead emerging in the operating reserve market.

If the AEMC chooses to progress an operating reserve over a longer timeframe (an amended option one or two), it will be important to consider how storage capacity would operate under such an arrangement as these assets could both charge and discharge in the same time period.

The CEC notes that the AEMC has briefly outlined a variation on a callable operating reserve market in the directions paper. There is some confusion across our membership about how this would practically work so the AEMC would need to provide more detail on this if it is to be considered further.

In the draft determination, the AEMC should clarify whether an operating reserve, particularly as envisaged under option three (and option two), is intended to replace the current reliability and reserve trader (RERT) framework. The AEMC should also clarify how an operating reserve would work alongside the current lack of reserve 3 (LOR3) framework.

Cost recovery

Key elements to be settled for a successful operating reserve are how demand for the operating reserve is determined and how costs will be recovered. Whilst a causer pays approach is often preferable, it is not immediately apparent how it could work for an operating reserve as it would be difficult to attribute the cause of the need for the service to any particular market participant. The simplest approach may be for the cost of the operating reserve to be borne by consumers. If this is the case, the demand for operating reserves would need to be set appropriately, and most importantly, not too conservatively. Under such an arrangement, the AEMC should consider mechanisms to allow consumers the opportunity to avoid the costs of the service by reducing their own demand.

Thank you for the opportunity to comment on this consultation. If you would like to discuss any of the issues raised in this submission, please contact me on lpatterson@cleanenergycouncil.org.au or (03) 9929 4142.

Yours sincerely,



Lillian Patterson
Director Energy Transformation