NEM Review Secretariat

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30 September 2025

ESEM Policy Design Papers

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Expert Panel's consultation on the ESEM Policy Design Paper.

The Australian Energy Council is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

Anticipated Entry Trajectories

- Support meeting reliability standard at least cost to consumers. If jurisdictions want to meet a standard higher than the reliability standard, it should be funded by the relevant jurisdiction.
- Unclear how AEMC target statements can usefully guide trajectory in practice. AEMC target statements are broken into two categories:
    - Category 1 – Targets for reducing Australia's greenhouse gas emissions. These targets are set both federally and at jurisdictional level, and reference years are 2030, 2035 and 2050.
    - Category 2 – Targets likely to contribute to reducing Australia's greenhouse gas emissions. These targets are more electricity sector specific, but are expressed in a variety of ways, and include somewhat tangential policy measures.
- Emissions reduction targets are most efficient when national and economy wide, and electricity specific emissions reductions targets run the risk of a higher cost emissions reduction trajectory. We note the Expert Panel prefers the ESEM administrator should only have regard to electricity sector targets. Work is required to create sector specific targets which would better support the ESEM administrator:
    - There should be quantitative modelling to show how the electricity targets translate to trajectories across the three different services, namely bulk VRE, shaping and firming.
    - We think the modelling should extend to the level and trajectory of Essential System Security Services (ESS) as well, as shortfalls in ESS can contribute to the delay of closure of existing thermal plants and therefore reliability outlook.
    - Only explicit jurisdictional electricity targets should be included (e.g. renewable generation target should be included but technology-specific or productivity targets should be excluded). The ESEM Administrator should also give weight to energy technologies that reduce emissions (e.g. converting landfill into power), rather than simply a requirement to be zero emissions.
    - Consideration should be given on how the trajectory modelling treats both transmission build and plant exits to inform what mix of generation is required by when.
- There should be a volume principle that limits the amount of contracting on a yearly basis, to manage the risk of over-procurement.

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  - In addition to the in-built automatic stabilisers in the ESEM (e.g. rolling updates and market "look-back"), the Panel should also consider a longer-term high-level metric (e.g. on an annual basis) to manage the risk of over-procurement. This would create guard rails over and above the automatic stabilisers in managing over-procurement given the timing and "lumpy nature" of capital-intensive generation/storage investment.
- There is a disconnect between the current reliability gap assessment which is the ESOO (ten-year outlook) and the desire for a 15-year trajectory to be made transparent to the market. We think these should align through extending the ESOO to 15 years.
- Further detail is needed as to how the ESEM administer will incorporate into its trajectory projects that are built and contracted outside of the ESEM.

Competitive Bidding Process

- The AEC's primary concern is what skills and knowledge will be prioritised within the ESEM administration. The AEC view is the ESEM administrator should, first and foremost, have commercial expertise and some sophistication with respect to bid assessment.
  - While the AEC is comfortable with the Panel's proposed mechanical role for the ESEM in terms of not contemplating social criteria, the bid assessment process should still have regard to matters of market efficiency – for example, an ability to assess the likelihood of a project going ahead once it has been awarded a tender. This might necessitate having penalties in place if a project is not built in time.
- Further information is needed with respect to how the ESEM will operate in the early years when there is no bid data for comparison. The proposal to compare projects with LCOE invites several questions:
  - How will LCOE be determined?
  - What happens if no bids are awarded across multiple quarters because they are all above LCOE? Will the ESEM administrator be bound by LCOE estimates, or take the market feedback and adjust its expectations?
  - Will the ESEM administrator have the power to reassess the accuracy of the applied LCOE, and then related to above, how to ensure the ESEM administrator has the necessary commercial competency to perform that reassessment?
- Bond requirements must be strong and robust enough to prevent speculative bidding.
- A least cost approach should include provisions to allow existing plant, especially firming, to participate. Second best is to allow for refurbished/expanded plant to participate and repowering of plants should be allowed where it is lower cost than new projects.
- In addition to tender design, governance needs to ensure:
  - The ESEM administrator should be the public body that coordinates the contract co-design process.
  - ESEM administrators dealing with the market should be predominately commercial rather than regulatory.
- Where possible, information should be published to outline all ESS requirements, including system strength, inertia, and network control and system restart services, as part of each ESEM tender.

Cost Recovery

- The AEC has concerns that the cost recovery model might incentivise jurisdictions to push their energy policy ideas off budget and onto the ESEM (i.e. in a manner that is more regressive than via taxpayers). This can be limited by tighter parameters around what constitutes an electricity target.

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- Further work is needed with respect to how the relief mechanism will work in practice. While the AEC understands the intent to create exemptions for customers that contract outside the ESEM, if exemptions for large customers are widespread, then it will create a situation where cost recovery falls disproportionately onto smaller customers via retailers.

Contract Recycling

- The effectiveness of contract recycling goes back to the earlier point about what set of skills the ESEM administrator will have – i.e. the administrator will need to have commercial experience to manage these risks effectively.
- The ESEM should be established as a commercial entity (not a public service entity) and be required to hold an Australian Financial Services Licence (AFSL).
- The risk management arrangements would best be set by the Board of the ESEM administrator, not ECMC. The risk management framework is key to contract recycling working effectively – we think there will need to be a balance to ensure good consumer outcomes, and also to ensure the market is not distorted / shocked periodically with large / unforeseen contracts being recycled unexpectedly.
    - The AEC remains concerned that the ESEM administrator will likely hold significant financial risk, and these costs will be passed onto customers. It is important there is sufficient consultation with industry about the risk management framework that will be in place.
- The ESEM should have the power to restructure contracts when recycling (e.g. sell a combination of bulk, shaping and firming contracts tailored to the need of buyers) and operate out of sequence when necessary to minimise costs.
- The Panel should consider whether contract recycling should be subject to a limited time period (e.g. the first three years).

Competition

- The AEC accepts in principle the theoretical reasoning for having a market concentration threshold. The challenge is with respect to establishing whether there is a competition problem and what the factors are that going into deciding that threshold. This will involve consideration of:
    - Weighting of different services (market concentration is more relevant with respect to shaping and firming than bulk VRE).
    - Operation of asset vs financial control of asset.
    - Whether VPP and related aggregated generation should be excluded.
    - Frequency of assessment (e.g. generation portfolios of businesses will change substantially through the energy transition, level of investment and from who under the ESEM is not known yet, as well as effect of unknown events such as merger and acquisitions).
- Notwithstanding the above, the AEC notes the likelihood and gravity of anti-competitive behaviour should be mitigated by the ESEM's design features (e.g. if contracts are being sold to the ESEM administrator and the seller has to make CfD payments, and the ESEM administrator having the authority to on-sell the contracts to parties that want them).

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