

NEM Review Secretariat

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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 and is committed to delivering the energy transition for the benefit of consumers.

Investment aligned with technology specific targets

- The AEC takes the view that the ESEM is a welcome approach to procuring via the required energy services, which offers a better prospect of supporting market design which is broadly technology neutral. Accommodating jurisdictional preferences through specific technology-focused goals is fundamentally inconsistent with this rationale. While acknowledging the need to accommodate jurisdictional preferences to some degree, this approach risks incurring material costs for consumers.
- Only where there is an enduring market failure should Government intervene. It follows that specific technology targets should only be created where Government has come to a view that there is an enduring market failure and that the NEM and consumers would benefit from the introduction of the given technology.
- As the Expert Panel explains, technologies like pumped hydro, biomethane and offshore wind may be desirable components of the energy mix, but face barriers beyond the tenor gap.
- Technologies such as pumped hydro, with long lead times, uncertain revenue profiles arguably fall into this market failure category. Historically, we have seen a level of direct Government involvement to support pumped hydro investment, particularly larger scale pumped hydro projects.
- Offshore wind is another technology specifically targeted and would likely need Government support over and above the tenor gap the ESEM is designed to address. Whether offshore wind is an example of market failure or simply is not cost competitive relative to onshore wind remains to be seen. From a tender design perspective, there is no obvious reason onshore and offshore wind could not run in the same tender.
- Biogenic sources of generation offer broader emissions reductions benefits beyond zero emissions electricity, as well as local reliability benefits. Given its non-standard characteristics, a specific tender could be a reasonable approach for this part of the generation mix.
- If a particular jurisdiction wanted to opt for a more expensive technology, it would be open for that jurisdiction to do so with cost recovery happening within that jurisdiction.
- A complication to the cost recovery principle is where neighbouring jurisdictions and / or the Commonwealth come to the view that the beneficiaries of a specific technology are spread across the NEM or largely reside in a neighbouring jurisdiction. In this scenario, consideration should be given to incorporating these wider benefits into an alternate cost

recovery approach where the relevant jurisdictions agree. This would enable the relevant jurisdictions to come to an agreement, whilst preserving the ability of other jurisdictions to maintain their ability to self-select an alternate approach.

- Importantly, no single jurisdiction should be allowed to specify a technology and then cost shift the costs of this technology onto other jurisdictions without their express agreement. The general rule of cost recovery in the relevant jurisdictions is a useful discipline.
- The framework must allow for the identification of the core service costs and residual costs. The core service cost could be determined or informed by the average clearing price from the equivalent service-based tender in the relevant region (e.g., the bulk energy service tender for offshore wind).
- The residual component - which reflects the difference between the special tender clearing price and that core service cost - represents the cost attributable to the technology preference and is intended to be funded by the jurisdiction. If technology-specific procurement is adopted and exercised, any associated additional costs should be transparently reported and communicated, with accountability for those costs remaining with the responsible government

Strategic reserves

- There is an unclear policy rationale for why a strategic reserve is required. Is it designed to induce supply over and above what is required to support the Reliability Settings? Is it designed to address high impact, low probability events, or tail risk? What is the rationale over and above relying on the RERT?
- To the extent a strategic reserve is established, triggers for activation should ideally be in the NER, to avoid its politicisation. The strategic reserve capacity should only be activated when specific, predetermined triggers are met, in order to prevent market distortion, avoid crowding out private investment, and maintain appropriate price signals for in-market participants
- At a high level, the proposed triggers for activating strategic reserve capacity include:
 - Exhaustion of RERT: The capacity could be activated only after RERT (Reliability and Emergency Reserve Trader) has been exhausted.
 - Alternative to Load Shedding: Activation could occur as an alternative to load shedding.
- To the extent the strategic reserve is targeted at meeting a reliability standard above the reliability standard, it follows that funding should be from jurisdictions, not energy consumers, whose willingness to pay for energy reliability is a key input in setting the reliability standard.
- Similar to the technology specific tender, to the extent jurisdictions and the Commonwealth form a view that a strategic reserve can drive NEM wide benefits, the cost recovery approach could incorporate these wider benefits into an alternate cost recovery approach where the relevant jurisdictions agree.
- It is also important to recognise that establishing a strategic reserve will drive cost into the energy system. We think jurisdictions should fund procurement, with transparency of the costs of doing so.
- Care should also be taken to avoid the scenario where new projects bid into the strategic reserve due to its lower risk profile than bidding into the ESEM or in market. This could increase the reliance on procurement of higher cost reserve capacity over time if participants bid into reserves rather than the primary energy market.