

Is the ESB role now redundant?

1. SUMMARY

Before the establishment of the Energy Security Board (ESB), best-practice NEM governance was in place whereby Australian Energy Market Operator (AEMO), the Australian Energy Market Commission (AEMC) and the Australian Energy Regulator (AER) each had separate functions providing confidence for investors and consumers in the roles and responsibilities of each body.

However, concerns were raised in the 2017 Finkel Review about reform delays due to the institutional discord between the AEMO and AEMC. To address this, the Energy Security Board (ESB) was established in August 2017, comprising the heads of each of the three market bodies and an independent chair and deputy chair to deliver on four key outcomes of the Finkel Review: increased security, future reliability, rewarding consumers and lower emissions.

Of the four key outcomes sought under the Finkel Review the ESB has been less successful. Five years on from its establishment in 2017, the ESB has yet to deliver outcomes that to reward customers or lower emissions. Approaches to increase security and reliability have only partially been delivered, through the Retailer Reliability Obligation (RRO) and an enhanced reliability standard.

At the behest of the former federal government the ESB did successfully deliver a roadmap for major reform of the NEM, through the Post-2025 Market Design. However, the four areas of focus for the Post-2025 Market design are still to be delivered, including integration of distributed Energy Resources (DER) and flexible demand, mechanisms to manage resource adequacy (capacity) and aging thermal retirement and transmission access, with the fourth, essential system services now being progressed by the AEMC through a range of rule change proposals.

Over the last 5 years, the states have rapidly filled the former policy vacuum setting net zero targets and policies to support the development of critical transmission infrastructure and the uptake of renewable energy, as the fleet of coal-fired generators retire.

In parallel with the ESB's body of work, AEMO has been progressing the Integrated System Plan and updating its renewables integration study, whilst the AEMC continued in its role to consider rule changes put forward by market proponents.

Both the AEMC and AEMO have well-established new leaders and both have signalled the importance of collaboration between the two organisations. This provides stakeholders with greater confidence in returning to the original governance structure where the AEMC and AEMO have defined roles no longer requiring the oversights and coordination of the ESB.

The ESB's major work, the Post 2025 Market Design project, is complete and delivery of the reforms, where necessary, will be best progressed through Energy Ministers and Senior Officials.

We are calling on energy ministers to consider an alternative recommendation to the ESB:

- **An orderly wind up of the ESB as soon as possible, with any projects still deemed credible to be transferred to Senior Officials.**
- **A revised Statement of Role for AEMO and the AEMC addressing the roles in the provision of policy and market development advice.**
- **Institute a Market Bodies Forum (MBF) that gives energy ministers a singular forum to engage with Industry and Stakeholders on policy and reforms needed with independent body and Senior Officials as secretariat.**

2. WHY THE ESB WAS FORMED

The South Australian state-wide blackout in 2016 created intense pressures on the states and highlighted the security of the National Electricity Market (NEM). In response, energy ministers announced the commencement of the Finkel Review, which considered the energy system, market and governance framework.

The Finkel Review, completed in 2017, raised concerns about *institutional discord between Australian Energy Market Operator (AEMO) and the Australian Energy Market Commission (AEMC), resulting in reform delays*¹.

One of the Finkel Panel's key recommendations to address this discord was to create the Energy Security Board (ESB), comprising the heads of the market bodies and an independent chair and deputy chair. The ESB was to remain in place until 2020 to implement the other 49 (of 50) recommendations.

The ESB was quickly established, appointments made, and it was given the power to directly make rules under the National Electricity Law (NEL) Section 90F.

This power was a radical shift as it allowed the Federal Energy Minister to direct rule changes via the ESB, instead of the established process where the Australian Energy Market Commission had sole custody of the rules. This new power effectively enshrined ministerial intervention in market rules and policy.

The ESB soon departed from the Finkel recommendations, with ministers directing the ESB to:

- Develop the National Energy Guarantee, that subsequently became the Retail Reliability Obligation (RRO)
- Review the transmission rules to simplify Integrated System Plan (ISP) planning
- Undertake the Post 2025 Market Design project (P2025 project), and
- Implement an interim Reliability Standard.

The National Energy Guarantee was abandoned and, after introducing the Retail Reliability Obligation, the ESB focused on a single workstream, the P2025 project, rolling in all other tasks.

3. POLITICS, GOVERNANCE, COORDINATION AND THE ROLE OF INDIVIDUAL MARKET BODIES

While the ESB was established to respond to the discord between AEMO and AEMC, the former government and its ministers were quick to use the levers that the ESB presented to progress its own policy agendas through the directing the work and focus of the ESB.

While the former government never consolidated a consistent view on climate change and the reforms in the energy market that might address it, the political inertia, unsurprisingly drove both Labor and Liberal state governments to pursue their own policy and market reforms to secure their states energy and climate futures.

The introduction of the ESB did not facilitate the reforms necessary to adapt to a transitioning energy system and the misuse of the ESB by the former government to change and influence the direction of

¹ Finkel Panel, *Independent review into the Future Security of the National Electricity Market*, p. 165.

the energy transition has resulted in further delays. The difficulties the introduction of the ESB caused continue as the ESB unrelentingly pursues approaches that promote the now irrelevant policies of the former government, such as a capacity mechanism and the Coordination of Generation and Transmission Investment (CoGaTI, now renamed the “Congestion Management Model”).

There is a fundamental conflict between the outdated policies and approaches that the ESB continues to insist are necessary and the consensus view of industry participants and stakeholders that the reforms based on the legacy of the former government will not deliver the clean transition that Australia needs.

Historical reviews of energy governance

The original NEM governance intentionally separated the functions of:

- economic regulation and enforcement in the AER;
- market and system operation in the AEMO; and
- market design and rule-making in the AEMC.

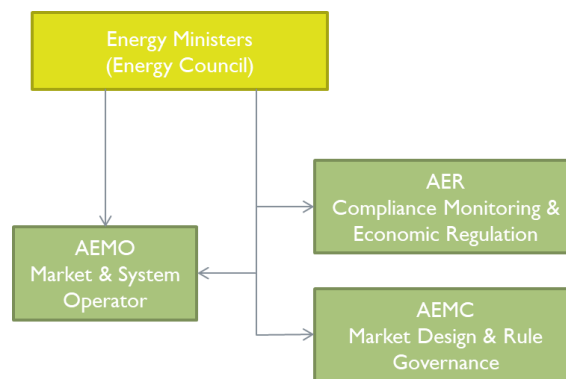


Figure 1: Original NEM Governance

This separation represented best-practice governance², providing confidence for investors and consumers in the roles and responsibilities of each body.

Several reviews initiated by the COAG Energy Council have considered energy governance and made recommendations regarding what they consider to be best practice.

In 2015, the Vertigan Review³ recommended retention of the (original) governance structure, with suggestions to expedite the rule change process, and to *clarify AEMO’s role*, particularly with respect to market design. Vertigan’s recommendations were never implemented.

In 2017, the Finkel Review⁴ also documented concern about institutional discord and reform slowness. Taking a different tack than Vertigan, Finkel recommended creation of an ESB, in which the heads of the AER, AEMC and AEMO would sit alongside an independent chair and deputy chair. The Finkel recommendations were partially implemented before the role of the ESB was re-oriented. The creation of the ESB has led to our current governance structure:

² [Review of Governance Arrangements for Australian Energy Markets - Final Report - October 2015 \(energyministers.gov.au\)](https://energyministers.gov.au/publications/review-governance-arrangements-australian-energy-markets-final-report)

³ <https://energyministers.gov.au/publications/review-governance-arrangements-australian-energy-markets-final-report>

⁴ <https://www.energy.gov.au/government-priorities/energy-markets/independent-review-future-security-national-electricity-market>

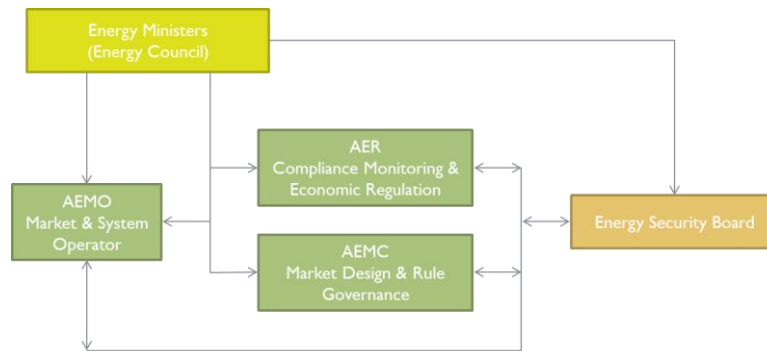


Figure 2: NEM Governance following the introduction of the ESB in August 2017

In mid-2020, the Edwards Review⁵ considered the long-term role of the ESB. Edwards recommended the ESB continue until the end of 2021 to complete the P2025, which was accepted by Ministers. Edwards further recommended disempowering S90F (this recommendation was rejected by energy ministers) and completing AEMO’s statement of role (agreed, but not yet actioned).

In November 2021, as the former chair of the ESB stepped down, the Chair of the AEMC became the chair of the ESB and the ESB is now part of the AEMC:

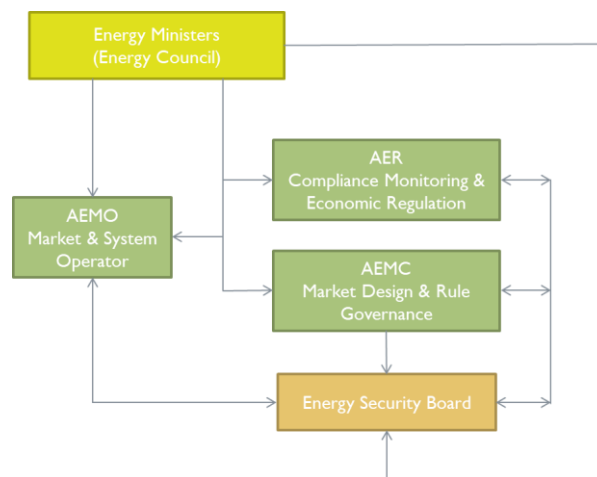


Figure 3: Current NEM Governance arrangements, with the ESB chaired by the AEMC chair (November 2021)

The introduction of the ESB, featuring the chairs of the AER and AEMC and the CEO of AEMO created a number of conflicts of interest. This is particularly the case for AEMO, which is an important participant in the system as the unregulated operator of the energy markets and the transmission system. Notionally the AER has the ability to ensure AEMO complies with the rules, but in practice the close working relationship necessitated by the ESB has meant that the AER has not been able to provide oversight of AEMO.

Additionally, AEMO has had a dominant role in designing the future market, with a large amount of ESB work occurring out of sight of other industry stakeholders. AEMO’s role in designing the future market potential means that the ESB goals of integrating DER and of developing flexible demand are predicated on designs that retain the primacy of the current wholesale market, approaches and rules, essentially

⁵ <https://energyministers.gov.au/review-energy-security-board>

treating residential customers no differently to a large multi-MW generator (with all the associated large-scale costs related to compliance).

The AER, with a primary role in compliance monitoring in the application of the rules and economic regulation, has via the ESB, been emboldened to develop policy, encroaching on the role of the AEMC and government.

Common findings across these governance reviews were:

- Clarity of roles between the AEMC and AEMO is needed for clear accountability and coordination and long-term certainty. It is acknowledged that the AER as a regulator has no role in policy development due to the conflict of interest between regulation compliance and good policy.
- The specific purpose of the ESB and its role need not be extended beyond 2021.
- Having a separate process for making rules (i.e. S90F) creates uncertainty and a pathway for government intervention. It is preferable to have a single, transparent rule change process.

4. WHAT HAS THE ESB DELIVERED AND WHAT HAS HAPPENED IN PARALLEL (VIA OTHER MARKET BODIES)

The ESB was created in highly political circumstances, with a role to coordinate reforms across market bodies. In this critical decade for action on climate change, its contributions should be assessed on whether the ESB will decarbonise the energy system at an accelerated pace with considerations to reliability, security, and affordability.

With that in mind, while the ESB has achieved partial implementation of the RRO (one of the Finkel Review recommendations), tightened the reliability standard (CoAG request), created actionable ISP rules (with AEMO) and developed Stage 1 Renewable Energy Zone (REZ) rules (CoAG request), it is important to note that the majority of effort and resources came from AEMO and the AEMC. ESB Chair Kerry Schott also submitted a request to the AEMC to require generators to provide three years of notice prior to closing a plant (originally a Finkel recommendation).

Meanwhile, the AEMC has continued in its role to consider rule changes put forward by market proponents and progressed reforms.

Box 1: Rule Changes & Market Reforms worked on by AEMC in parallel with ESB work program

- Streamlining the participation of storage in connecting to the NEM and participating in markets
- Fast frequency response and operating reserve markets development
- Primary frequency response for grid stability from large generators
- System strength framework for high renewables zones
- Project development and grid connection transparency reforms
- Wholesale demand response mechanism allowing DR aggregators to participate in the wholesale market
- Enhancing the transparency and structure of the reliability and emergency reserve trader (RERT) mechanism.

Elsewhere, under new leadership, AEMO progressed major reform on the Integrated System Plan (ISP) and updated its renewables integration study.

The states have sought to fill the central policy void by establishing clear ambitions for net zero by 2050 and backing this up through reforming renewable energy-oriented policies, plans and investment settings.

Table 1: NEM States Transmission Initiatives

Government	Initiatives
<i>NSW Government</i>	NSW Government has developed an Electricity Strategy ⁶ and Electricity Infrastructure Roadmap ⁷ which sets out a plan to deliver the State's first five REZs as well as developing the NSW Transmission Infrastructure Roadmap ⁸ with the support of the Federal Government ⁹
<i>Victorian Government</i>	The Victorian Government are supporting the development of REZs ¹⁰ , the Western Victorian Transmission Network Project ¹¹ and Victoria-NSW Interconnector project.
<i>Queensland Government</i>	Queensland Government are establishing three REZs ¹² and supporting the development of CopperString 2.0 and the Queensland-NSW Interconnector (QNI)
<i>South Australian Government</i>	The South Australian Government are supporting project EnergyConnect which will open up renewable energy zones with support from the Federal Government ¹³
<i>Tasmanian Government</i>	The Tasmanian Government have developed a draft renewable energy coordination framework which includes proposed Renewable Energy Zones ¹⁴ and are developing the Marinus Link ¹⁵

While the key role for the ESB formation was to coordinate and expedite reforms across the market bodies, there remains a lack of clarity, impetus, and limited coordination between them and the ESB, with the industry still beset by multiple regulatory reviews and rule change processes underway at a time when clear focus is needed to meet the challenges and opportunities offered by a rapid and harmonised approach.

5. WHAT HAS CHANGED OVER THE PAST 4 YEARS SINCE THE CREATION OF THE ESB?

The Federal Government is focusing on the nation building approaches that will deliver the decarbonisation agenda

The Federal Government has rightly focused on the need to implement a decarbonisation target and clearly understands the need to accelerate the transition to a low carbon energy system. Rewiring the

⁶ [NSW - Electricity Strategy](#)

⁷ [NSW Government's Electricity Infrastructure Roadmap](#)

⁸ [NSW - Transmission Infrastructure Strategy](#)

⁹ [NSW - MoU](#)

¹⁰ [The Victorian Government is developing Victoria's Renewable Energy Zones \(REZs\)](#)

¹¹ [West Vict NP](#)

¹² [Qld - Renewable Energy Zones](#)

¹³ [Ministers Taylor Media Releases - South Australia](#)

¹⁴ [Draft Renewable Energy Coordination Framework](#)

¹⁵ [Marinus Link](#)

Nation will deliver the urgently needed transmission that will unlock investment in renewable generation and storage, while allowing Australians to share in lower cost electricity.

However, reforms such as contestability in the building of transmission and delivering distributed approaches that allow Australians to reap the full rewards of their investments in DER, are urgently required. The continuing pursuit of the legacy reforms and policies of the previous federal government by the ESB are hampering the ability of industry and stakeholders to focus on the essential reforms that are now needed to meet climate targets and low carbon generation deployment goals.

By allowing the ESB to continue, the industry is shackled to the outdated approaches and policies of the past and there's not a moment to waste. The industry needs to be freed from the work of the ESB to ensure that arrangements support and deliver the investment and infrastructure needed to meet the federal government's ambitions.

The critical ongoing role of the states

The states and territories took the lead in 2020, introducing a range of ambitious policies to accelerate Australia's renewable energy transition. Most positively, these policies occurred across the political divide, with both Liberal and Labor governments making strong commitments¹⁶ to renewable energy and decarbonisation. This is already having a noticeable impact on the electricity system, with many states and territories setting records for renewable generation throughout the year. The proportion of renewable energy in almost every state and territory has increased significantly.

The states are implementing governance structures such as VIC Grid¹⁷ and the (NSW) Consumer Trustee¹⁸, to deliver on these policies as the challenges and risks facing the states are present and real. While it is heartening to see the renewed close collaboration with the states established by the federal government, the work of the ESB (and some of the AEMC) has now been superseded by the work of the states. Any reforms now developed by the market bodies must accommodate both the approaches of the states (table 1) and the policies of the federal government.

Change in leadership at AEMO and AEMC

Both the AEMC and AEMO have welcomed change in leadership over the past 12 months. At the AEMC, Anna Collyer has replaced John Pierce as Chair, who stood down from his 10-year post in June 2021.

There is broad support across the energy industry for the appointment of Anna Collyer due to her previous experience with energy law, active involvement in energy market reforms and experience with supporting innovation. Her appointment is seen as an opportunity for the AEMC to embrace faster reforms and keep pace with the accelerating transformation of Australia's energy sector.¹⁹

Daniel Westerman has replaced Audrey Zibelman as CEO of AEMO in what has been viewed as another positive move. Westerman brings the commercial, technical and regulatory experience to lead AEMO through significant change in the energy market. In his first speech since taking up the role in mid-

¹⁶ [clean-energy-australia-report-2021.pdf \(cleanenergycouncil.org.au\)](#)

¹⁷ <https://www.energy.vic.gov.au/renewable-energy/renewable-energy-zones>

¹⁸ <https://www.environment.nsw.gov.au/news/new-electricity-consumer-trustee-to-put-energy-consumers-first>

¹⁹ [New AEMC chair - a head of innovation - to embrace rapid market transformation | RenewEconomy](#)

May²⁰, he called for greater stakeholder collaboration with industry encouraged by Westerman's leadership:

"In order to maximise the benefits of this energy transition for the whole of society, all of us need to play our role and work collaboratively, together, and learn from one another; Committing us (AEMO) to greater openness, transparency and accountability for the interactions we have with all our stakeholders as we go about our work" Daniel Westerman, CEO of AEMO

Both Ms Collyer and Mr Westerman have signalled the importance of collaboration between the AEMC and AEMO. This provides stakeholders with greater confidence in returning to the original governance structure where the AEMC and AEMO had defined roles and the ESB was not required.

6. CONCLUSION

In the aftermath of the South Australian black system event, the Finkel Review created the ESB to expedite certain critical changes, but in doing so blurred the important functional boundaries of the market bodies. Now that the Finkel Review's implementation period is complete, it is worth reconsidering whether the remaining value of the ESB still provides benefits while it detracts from the original tri-institutional model.

With the new institutional leadership, a functioning policy and reform process coordinated through the state and federal energy ministers and consistent policy agendas towards net zero emissions targets, this begs the question of the ongoing role (and cost) of continuing the ESB.

WIND UP OF THE ESB UPON COMPLETION OF THE P2025 REPORT

The recommendations of the Edwards review appear to largely align with previous views expressed by many stakeholder submissions which we endorse as a forward approach.

These include:

Box 2: Recommendations

- 1) *An orderly wind up of the ESB as soon as possible.*
- 2) *A revised Statement of Role for AEMO and the AEMC addressing the roles in the provision of policy and market development advice.*

COORDINATION OF THE MARKET BODIES BEYOND THE ESB

Essentially the majority of effort by the ESB has been achieved through shared resources from AEMO and the AEMC. This makes the handover of any ESB ongoing initiatives seamless. To improve coordination between the market bodies to provide a single, authoritative source of reporting and coordinated advice without a statutory role can be achieved through a Market Bodies Forum (MBF):

²⁰ [AEMO | AEMO CEO Daniel Westerman's CEDA keynote address: 'A view from the control room'](#)

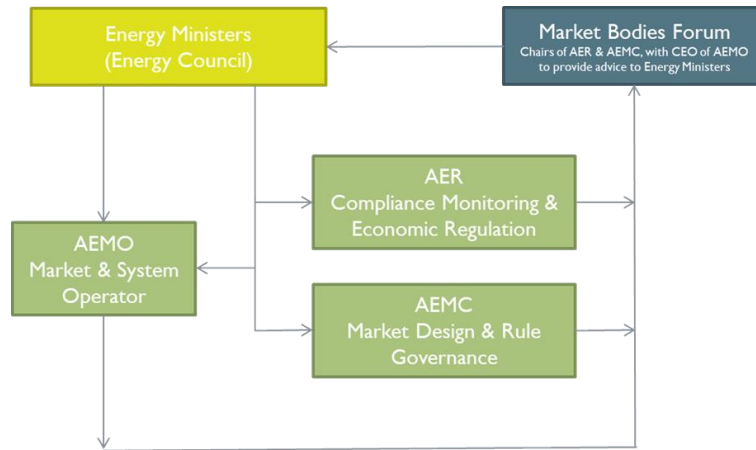


Figure 4: Proposed NEM governance model post-ESB

The concept was recommended by the Edwards Review and has been supported by majority of Industry and stakeholders. The MBF can play a key role in coordinating the market reform decarbonisation agenda and reforms needed including response to emerging issues and trends by utilising all mechanisms and powers available to its members and assist ministers in delivering the regulation and policy agendas in an open and transparent manner.

Box 3: Recommendation

- 3) *Institute a Market Bodies Forum that gives energy ministers a singular forum to engage with the heads of the market bodies on policy; Senior Energy Officials to play a key role in leading the forums and be represented to give government clarity as well as industry. Senior officials should be responsible for working with the market bodies and Industry to develop this forum.*

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The Nexa Advisory team is a collaboration of passionate energy specialists, all committed to the successful transformation of Australia's energy markets. The team is focused on helping clients grasp the unpredicted opportunities the energy transformation will bring. The decentralisation of energy promises, for the first time, to enable a truly democratised ecosystem with people and communities at the centre. We believe in an energy industry where people are at the centre of every recommendation we make. This belief guides our approach to the challenges we solve, and the outcomes we create.

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