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Department of Climate Change, Energy, the Environment and Water



Submitted online

Proposed Extension of AEMO's East Coast Reliability Functions

The Australian Financial Markets Association (AFMA) is responding to the Department of Climate Change, Energy, the Environment and Water's (DCCEEW) consultation on the Proposed Extension of AEMO's East Coast Gas System (ECGS) Reliability and Supply Adequacy Functions.

AFMA is the leading industry association representing Australia's financial markets - including the capital, credit, derivatives, foreign exchange, and other specialist markets such as gas, carbon, electricity and environmental products. Our membership is comprised of over 140 of Australia's leading financial market participants, including key participants in the east coast gas market.

Key Points

- **AFMA supports better coordination of the various gas market interventions**
 - **We are concerned that the overuse of the RSA could undermine investment signals and want it to only be used as a genuine last resort**
 - **The RSA contracting requirements should be more flexible**
 - **Which body is best placed to negotiate RSA agreements should be considered as part of the review of AEMO's governance arrangements**
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1. Strategic approach to gas market powers

AFMA's members have been concerned by the recent proliferation of overlapping mechanisms aimed at ensuring east coast gas security. We are therefore encouraged that the consultation paper recognises the challenges these interventions have presented to the industry and welcome moves to streamline the regulatory framework, and clarify how the various instruments, including the proposed Reliability and Supply Adequacy (RSA) function, are intended to interact.

While we are not convinced of the need for the new RSA function, we think that clarifying that it is a last resort power that will only be used to address structural shortfalls when other market-based instruments have been unable to address the issue, provides important clarity to the market about how the RSA function will be used.

2. Reliability and Supply Adequacy

2.1. Last resort

AFMA supports the RSA function being a last resort function that is only used when other market-based mechanisms have failed to address identified structural shortfalls, but we are concerned about how this will be implemented in practice. AFMA considers that generally, the market is the

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best judge of when investment is required and hopes that the RSA function will be used rarely, if at all. Our members are concerned that the prospect of AEMO intervention in the market will disincentivise prudent market led investment and encourage market participants to rely on AEMO to manage their medium and long term risks. We are concerned this will lead to less efficient outcomes and higher costs for consumers .and therefore consider that, if the RSA function is introduced, it should be as a genuine last resort function.

Our members have two main concerns about AEMO's ability to use the RSA function as a genuine last resort. The first is a practical concern that the long investment timeframes for many of the types of projects that the RSA is likely to underwrite will mean AEMO may have to make investment decisions quite early while there is still considerable uncertainty about actual supply and demand. Members are concerned that AEMO's institutional focus on system security is likely to make it overly conservative resulting in RSA investments being triggered unnecessarily, disincentivising the market to act prudently and increasing costs for consumers.

Members are also concerned about the extent to which the use of the RSA functions as a last resort relies on AEMO accurately forecasting supply and demand. Forecasting gas supply and demand in the current dynamic, transitional environment is extremely difficult as it is heavily influenced by changing customer usage patterns driven by increasing electrification and highly variable assumptions about gas fired generation consumption based on the trajectory of the electricity market's net-zero transition. In this context, our members note that AEMO's medium and long term forecasts have not been particularly accurate and have tended to adopt a conservative approach that identifies potential shortfalls that ultimately do not come to pass, partly as a result of market responses to AEMO's publications. In addition to the general difficulty of forecasting supply and demand, our members are concerned that the approach AEMO has adopted to forecasting demand under the "step-change" scenario has reflected the impact of government climate policy too mechanically and, particularly, failed to represent the significant uncertainty around coal generation closure dates. Assumptions about gas fired generation demand are very sensitive to coal closures and our members are concerned that failing to fully reflect the complicated market dynamics of these decisions has resulted in divergences between AEMO and the markets' views on the likelihood of shortfalls. We therefore think there needs to be significant improvement to AEMO's forecasting capability, particularly regarding the impact of coal closures before it can be relied on to support the RSA functions.

2.2. No reasonable prospects

While we have concerns about how AEMO will identify shortfalls, we think the proposed "no reasonable prospects" test is appropriate for a last resort power as it will only allow AEMO to propose intervention when there is no serious prospect of a market response. Additionally, we consider that the requirement for AEMO to obtain ministerial approval before acting will serve as an appropriate check on use of the function.

Additionally, we think the triggering process could be improved by ensuring there is appropriate guidance about how material a shortfall must be before AEMO can use the powers and restricting how far in advance of a shortfall AEMO may act. We think AEMO should be required to inform the market of an identified shortfall that may trigger use of the RSA function and give the market adequate time to respond to the shortfall prior to AEMO deciding to use the RSA function. In practice, we think it is unlikely that structural shortfalls will appear unexpectedly and there will

generally be adequate time for the market to respond, assuming that AEMO does not disrupt this process by intervening unnecessarily.

2.3. RSA contracting

AFMA anticipates that the RSA function will be used rarely, if at all. As a result, we think it is difficult to anticipate the circumstances when it could be used, and highly problematic to identify the type of investments required and what procurement process or form of contract will be most suitable for them. While we think there would be value in providing some guidance about the types of transactions AEMO is able to enter into for the RSA function, for instance are they permitted to trade in LNG spot? We are also concerned that the proposed restrictions on how AEMO could contract RSA services, while well intentioned, are likely to complicate procuring the services and may undermine the effectiveness of the function.

We consider that as it is extremely difficult to predict how the RSA function will be used, it is appropriate to leave maximum flexibility about how RSA contracts should work. We want to note that mandating particular contract types has proved operationally difficult for other schemes, such as the Capacity Investment Scheme, even when the service being procured is well understood in advance. We think that attempting to mandate procurement models or contract types for RSA services is likely to present significant practical challenges for AEMO if they are called on to use the RSA functions. We anticipate this is likely to be particularly challenging for services, such as pipeline augmentations, where there is likely to only be a single provider who can realistically provide the service and we think AEMO will need the flexibility to contract that reflects the commercial reality of the project.

We also think AEMO should have flexibility about the commercial structure that it uses. The proposed models assume the purchase of services by AEMO and then the on sale of these to the market, while we think this could be one way that AEMO may choose to contract we also think having access to other options would be beneficial. For instance, the policy rationale for the RSA is that the market has failed to contract a service in a large part because of uncertainty about future demand. It is therefore possible that AEMO may be able to facilitate investment by entering into an option contract to underwrite a new investment but ultimately not have to exercise the option as, once the project proceeds, the provider is able to find commercial counterparties. It is possible to envisage countless similar structures that could allow AEMO to achieve the policy aims at lower cost and with less disruption to the market, and we do not think the regulatory regime should obstruct this.

2.4. Role of ministers

AFMA considers that it is appropriate for state ministers to be responsible for deciding if the RSA will be triggered in their jurisdiction and they should have oversight of how AEMO performs its functions and the recovery of costs, but we do not think it is appropriate for ministers to be involved in determining the commercial arrangements for the provision of RSA services. As stated above, we think that given the uncertainty about what services may be required and the commercial challenges of contracting them, AEMO will need significant flexibility to allow them to do this efficiently. While we think it is appropriate for states to have oversight of this process, we do not think it is appropriate for them to be directly involved in it as they (and their departments) generally do not have the commercial skills required to facilitate this process and unduly restricting how AEMO can perform the function is likely to hamper the use of the RSA functions and increase the cost of the functions.

2.5. Resale of RSA services

The consultation paper proposes that AEMO should be required to resell RSA services that it procures through auctions or markets administered by AEMO. AFMA supports AEMO reselling the services but is unsure if the markets and auctions that AEMO currently administers are suitable for reselling the types of services that are likely to be procured under the RSA function. While we see value in the transparency provided by AEMO's current markets and auctions, we think it might be appropriate for AEMO to resell services through longer term auctions to ensure that the RSA services are able to provide the most value to the market and to minimise the cost of the scheme, while preserving transparency.

While it is impossible to know what type of RSA services AEMO may procure from the consultation paper, it seems likely that the RSA function will involve AEMO underwriting longer term investments and therefore, it is likely that AEMO will have to enter into longer term (>12 months) agreements to procure these services. By contrast, the markets and auctions administered by AEMO are predominately short-term spot markets, with only the Gas Supply Hub (GSH) having capacity for transacting for periods longer than one day ahead and most transactions on it being for periods of less than one month. As a result, we think it would be sub-optimal for AEMO to be restricted to reselling long-term contracts through these short-term markets as neither AEMO or market participants would be able to benefit from the increased certainty that could come from longer term transactions.

We therefore suggest that AEMO should be able to resell RSA products through new longer-term auctions, as contemplated for the Electricity Services Entry Mechanism (ESEM) recommended by the NEM Market Settings Review (NEM Review), rather than being required to use the existing short-term markets and auctions. These types of auctions could be run in a similar way to the tenders currently run by ASL and we do not anticipate that they would need AEMO to invest in new market platforms. We also note that, as discussed above in section 2.3, there are a range of options about how AEMO could underwrite RSA services that would not require it to actually procure services in which case, AEMO would not need to resell the services.

2.6. Specialist body

Since the commencement of this consultation the Energy and Climate Change Ministerial Council (ECMC) has announced a review of AEMO's governance arrangements, which includes consideration of "whether changes are warranted to enhance the formal corporate legal structure of AEMO including its associated entities." We consider that the governance of the RSA procurement functions should be considered as part of this review and note the energy market has recent experience of central procurement of services that the market has not provided under the Capacity Investment Scheme and NSW's Long-Term Energy Service Agreements. For both schemes, policy makers and AEMO determined that AEMO was not an appropriate body to negotiate and enter into commercial agreements with market participants and decided to establish ASL as a specialist commercially focused body to perform these functions. Additionally, the recent NEM Review has also recommended that a specialist body administer its proposed ESEM, which would include both procuring and reselling services in a similar way proposed for the RSA functions.

We anticipate that the AEMO governance review will consider if a specialist commercial body responsible for entering into commercial agreements with market participants will be a continuing feature of the energy market. AFMA thinks that review should consider if ASL, or its successor organisation, should be responsible for the procurement of RSA services as it is more likely to have

the appropriate expertise than AEMO. We think AEMO should continue to be responsible for identifying shortfalls and making recommendations to ministers to trigger the RSA functions but consider that ASL or a similar body would be more suitable to procure and resell the services.

2.7. Cost recovery

AFMA has significant concerns about the proposed cost recovery arrangements for the RSA function. We consider that, to the extent practical, they should attempt to allocate the cost of the RSA functions to the parties who have caused these services to be required. We consider that the proposed approach risks misallocating costs between jurisdictions and class of customer and have the following suggestions to better allocate costs to cause.

As noted in the consultation paper, a significant driver of the need for the RSA is a lack of long-term contracting by end users. The paper identifies mass market, C&I and gas fired generation as the key classes of gas users and proposes splitting the costs between them broadly in proportion to their usage. While this approach has the benefit of simplicity, we think it will inappropriately expose users who have prudently managed their exposure to costs incurred as a result of participants who have not adequately managed their exposures. We therefore think that cost recovery should adopt a similar approach to that recommended in the NEM Review for the ESEM where parties who have managed their risk should not have to pay RSA costs. While we think that costs to gas users will have to be determined individually, our general observations are that retailers have largely prudently contracted for their fairly predictable mass market demand and for their contracted C&I demand. Likewise, gas fired generation also manages its position prudently given the variable nature of its demand, while generators generally do not use the same types of firm supply agreements as contracted retail demand, they generally have access to a range of flexible supply options and are extremely responsive to both gas and electricity market signals. On the other hand, uncontracted C&I customers generally purchase most of their gas through spot markets and take limited steps to manage their exposure.

We also consider that the proposed forecasting approach for apportioning costs between jurisdictions leaves wide margins for error in the early periods when there is limited actual consumption data to base the allocation on. We suggest that forecasts should be required to be updated as frequently as practicable and there should be a mechanism to remunerate users in affected states if forecasts differ significantly from actual consumption.

AFMA Recommendations

- i. The RSA should be a last resort function.
- ii. There should be clearer guidance about when and how AEMO may use the RSA powers.
- iii. AEMO should have flexibility in how it contracts RSA services.
- iv. AEMO's forecasting ability should be enhanced, particularly its ability to reflect uncertainty around coal closure dates
- v. Ministers should not be involved in determining the commercial arrangements for RSA services.
- vi. AEMO should be allowed to resell RSA services through longer term auctions, in addition to being able to use its existing short-term markets.

- vii. The AEMO governance review should consider if a specialist commercial body should be responsible for entering into RSA contracts.
- viii. Cost recovery for the RSA functions should allocated costs to causers.

3. GSOO

AFMA supports improving transparency in energy markets and reviewing the scope of the Gas Statement of Opportunities (GSOO) to ensure that it remains fit for purpose. But AFMA is also aware that there has recently been significant expansion of data requirements for energy market participants. This expansion has often been poorly coordinated with essentially no information sharing between different market bodies and often duplicative with burdensome obligations on reporting entities which have been costly to comply with.

AFMA has called for greater efficiency in the way data is collected during a number of regulatory processes including our response to your department's review of the Gas Market Code,¹ and we were pleased to see that the review's final report found that:

Reporting obligations contained in gas market regulations ... have created undue regulatory burden for gas market participants. These costs are passed through to gas buyers, contributing to higher costs.²

And recommended that:

Consolidation of reporting requirements through reduced administrative and reporting burden for gas producers could translate to lower prices over time.³

AFMA therefore encourages DCCEEW to look to use existing data for any enhancements to the GSOO, where possible and ensure new data requirements are minimised and implemented efficiently.

AFMA Recommendations

- ix. AEMO should rely on existing data for any enhancements to the GSOO where possible.
- x. New data requirements should be minimised and implemented efficiently.

AFMA would welcome the opportunity to discuss this submission further and would be pleased to provide further information or clarity as required. Please contact me at lgamble@afma.com.au or 02 9776 7994.

Yours sincerely,



Lindsay Gamble

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¹ <https://afma.com.au/policy/submissions/2025/r47-25-gas-market-review.pdf?ext=.pdf>

² Finding DD <https://www.dcceew.gov.au/sites/default/files/documents/gas-market-review-report.pdf>

³ Recommendation 14 <https://www.dcceew.gov.au/sites/default/files/documents/gas-market-review-report.pdf>