Department for Energy and Mining
Firm Energy Reliability Mechanism – Stage 2 Consultation
GPO Box 618, Adelaide, South Australia 5001

Submitted via dem.ferm@sa.gov.au

14 July 2025

Firm Energy Reliability Mechanism

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Department of Energy and Mining's consultation on the *Firm Energy Reliability Mechanism – Stage 2* ('Consultation Paper').

The AEC 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.

To date, the AEC has given principled support to the Firm Energy Reliability Mechanism ('FERM') even if government underwriting schemes are not usually the most efficient mode of investment. This in-principle support is based on recognition of South Australia's intent to encourage investment in firming generation, especially gas-powered generation, which AEMO says is needed to maintain reliability and system security in a high VRE system like South Australia and eventually, the wider National Electricity Market ('NEM').

However, the design changes proposed in the Stage 2 Consultation Paper represent a significant departure from Stage 1 and warrant deeper consultation with industry. The proposal to enforce a Notice of Intention ('NOI') on existing generation in South Australia effectively functions as a capacity market mechanism and is fundamentally inconsistent with the energy-only design principles of the NEM.

The AEC encourages the Department to maintain its commitment under the National Energy Transformation Partnership (NETP) and supporting Renewable Energy Transformation Agreement (RETA) to collaborate and align across the NEM where possible. For example, if the Department has evidence that the additional information provision would better serve the interests of energy consumers, then all NEM consumers should benefit. A rule change request or a Minister-led rule would be preferable to the NOI.

Enforcing state-specific arrangements on existing generation also seems contrary to South Australia's investment in greater interconnection. Given that there is the NEM Wholesale Market Settings Review currently underway, the Department's decision to imminently introduce a mechanism that will significantly impact existing market structures and behaviour is short-sighted. The AEC strongly encourages the Department to undertake deeper consultation with stakeholders, industry, and the NEM Expert Panel to work through the FERM's final design and maintain alignment with the NEM's current energy-only market settings.

A mandatory capacity commitment is a substantial new obligation

The AEC disagrees with the characterisation of the NOI process as a form of simplified scheme participation for existing generators. A mandatory capacity commitment does not address the

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 92 608 495 307

primary concern raised in the Stage 1 consultation, which was to provide an option for existing generators to choose not to participate in the FERM.

A mandatory capacity commitment is, in fact, a far more substantial obligation on existing generation than what was previously consulted on. The Department is clearly aware of this because it has imposed tier 1 civil penalties for non-compliance, which is reserved for the most severe market obligations.

Given this major shift in direction, it is unsatisfactory that the Department is providing no meaningful avenue for consultation, with the FERM's regulations set to be finalised and commencing in little over a month.

A mandatory capacity commitment will have deleterious impacts on the existing market

The capacity commitment proposal offers no performance incentives for existing generation making their capacity available, instead only penalising providers for non-compliance. The AEC considers there to be no precedent for such stringency, with previous policy proposals involving capacity commitments (such as the Energy Security Board's capacity mechanism and the recently implemented Orderly Exit Management Framework ('OEMF')) all providing compensation to participating generators.

The proposal, as is, will mean existing generators lose flexibility in the way they run and optimise their plants. This will have consequences for the volume of contracts they provide, which will need to be reduced to manage the risk of undefended contract obligations, as well as dampening incentives for retailers to hedge through the purchase of forward contracts. This would also limit the availability of firm contracts for retailers and large load seeking to hedge.

These risks are in addition to the reality that the characteristics of the South Australian market, which has small demand and high VRE generation, already make it a relatively illiquid and volatile market to operate in. We note that the AEMC's proposal to net settlement residue auctions (SRAs)[1] may further impact the availability of a product the AER acknowledges provides an effective hedge in South Australia.[2]

While the AEC acknowledges the intent to mitigate the risk of existing generation prematurely exiting the market, early exit is most likely to occur because of commercial rather than operational risks. Substantially limiting the flexibility of existing plant only increases their commercial risk.

The AEC strongly encourages further consultation on this requirement, giving consideration to other options, including:

- Allowing existing capacity providers the right to opt-out of the mechanism entirely, with no availability obligation. There are existing mechanisms, namely the Reliability and Emergency Reserve Trader (RERT) mechanism as well as AEMO's directions power, that can be relied on to manage Lack of Reserve (LOR) events.
- Providing existing generation with compensation for making their capacity available – this is a stronger commercial incentive to ensure existing generation stays in the market. However, given a capacity mechanism is a departure away from the energy-only

[1] Australian Energy Market Commission, 'Inter-regional settlements residue arrangements for transmission loops directions paper', 19 June 2025.
[2] Australian Energy Regulator, 'Wholesale electricity market performance report', December 2024.

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 92 608 495 307

design of the NEM, this would be better explored through the NEM Wholesale Market Settings Review.

- Rewarding existing generation for the provision of essential system security ('ESS') services to ensure they are receiving fair value for the system security, as well as reliability, services they provide. The AEMC is currently consulting on an AEC-led rule change designed to create a market for ESS.

If the Department is wholly committed to the proposed approach, then penalties should be a commensurate calculation relative to the capacity that is not available, with the guidelines adopting principles-based expectations such as "reasonable endeavours".

The FERM is not congruous with the direction of the NEM Wholesale Review

The Department has stated in the Consultation Paper that it must move ahead of the current NEM Wholesale Market Settings Review due to the immediacy of the reliability and resilience risks in South Australia.

While this urgency is appreciated, the NEM Expert Panel is expected to announce its draft recommendations within the next month, and final recommendations by the end of the year. Given that any new build of firming capacity, at least in the form of gas-powered generation, will take about four years at best,[3] it would seem plausible to work within the NEM Review's timelines.

Alternatively, the regulatory incentive framework for new firming capacity could progress separately from the requirements on existing generation. As stated, the introduction of a mandatory capacity commitment sits in tension with the energy-only design of the NEM, and with the direction of focus that the NEM Expert Panel has communicated at its recent stakeholder forums. This includes key market design questions that relate to the purpose of the FERM – such as improving market liquidity, leveling the playing between existing and new (subsidised) generation, and reinvigorating the NEM's existing market structures.

Given the likelihood of divergence, if the Department chooses to proceed with the currently proposed FERM design on the timelines provided in the Consultation Paper, then there should be a formal review mechanism added into the regulations to trigger at the end of 2026.

Performance obligations should be harmonised with recent NEM-wide policies

Consistent with the above, the AEC is concerned that the proposed performance requirements are not aligned with major NEM-wide reforms, namely the Capacity Investment Scheme ('CIS') and OEMF. For example, there is a disconnect between treatment of performance obligations in the CIS (deductions from annual payment when a performance threshold is not met rather than a focus on LOR events) and OEMF (AER determinations) compared to what the FERM is proposing.

As much as possible, the Department should seek to harmonise the performance requirements on existing and new generation with the CIS and OEMF to encourage regulatory efficiency and simplicity.

Mandatory trading obligations are not effective or efficient

The Department has proposed mandatory trading obligations on capacity, retailers and large load which ignores international and domestic precedent about their ineffectiveness.

[3] The two most recently built gas-powered generation facilities, Tallawarra B power station and the Hunter Power Project, each took about four years to come online.

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 92 608 495 307

Stakeholder submissions to the NEM Review were overwhelmingly consistent in their view that the national Retailer Reliability Obligation ('RRO') had failed and should be removed.[4] For example, the Australian Energy Market Commission (AEMC) submitted that:

> *We do not consider that the RRO would play a sufficient, efficient or optimal role in incentivising new investment in the future NEM. Further, we do not consider that a long-term RRO instrument would address these concerns. Fundamentally, the RRO is highly complex and places a significant compliance burden on retailers and some large customers while not resolving the fundamental contract length mismatch between retailers and generators.*

Market liquidity obligations ('MLOs') have also led to perverse outcomes in many jurisdictions by creating significant compliance costs, undermining existing arrangements and impeding the ability of load to hedge effectively. Ofgem's recent review found the costs associated with MLOs continue to outweigh the expected benefits.[5]

The availability of appropriate (and sufficient) financial contracts to hedge energy-only market risk is important to generators, storage, and load in the NEM. The NEM Review has acknowledged there is a need for new projects to underpin these contracts, as well as a mechanism to address the 'tenor gap' from increasing market and regulatory uncertainty driving a disconnect between contracts that load are willing to buy and those required to finance supply. We suggest the Department work with the NEM Expert Panel to support targeted, evidence-based reforms to support liquidity.

Proposed retailer obligation will increase costs

While the mandatory MLO may technically mean there are no breaches to the existing RRO, the FERM's proposed "always on" retail obligation with annual reporting requirements means retailers must establish compliance controls and monitor their obligations under two sets of reliability obligations. There is not sufficient detail to assess if these separate reliability obligations will align. Unanticipated breaches and RRO triggers could also arise via changes in AEMO's modelling approach, assumptions, and weather reference years that cause divergences between the Electricity Statement of Opportunities (ESOO) and the Firm Energy Target (FET) setting and auction schedules. These uncertainties risk pushing retail prices higher for South Australian consumers.

Furthermore, requiring market customers to hedge to the one-in-two-year peak demand level will likely result in retailers building in a risk buffer relative to their own individual peak demand levels. These two peaks are unlikely to perfectly coincide, meaning that the total level of contracts required will be greater than the total system peak. Such a requirement would place significant demand pressure on the contract markets, which is likely to increase contract market prices.

The FERM's costs need to be transparently reflected in the Default Market Offer

The Federal Government has recently announced reforms to the Default Market Offer ('DMO'), ostensibly to reduce the retail cost stack. This is despite the retail cost stack being far smaller (16 per cent) than the wholesale (38 percent) and network (39 per cent) cost components. This will ultimately place pressure on the ability of retailers to operate, with South Australia already being a challenging retail market.

---

[4] Submissions can be accessed via: consult.dcceew.gov.au/nem-review-initial-consultation.

[5] Ofgem, 'Summary of Responses: Power Market Liquidity Call for Input', 29 August 2024

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 92 608 495 307

It is important then there is transparency over the cost recovery mechanism and it is included in the AER's DMO cost stack. This is necessary to ensure retailers are able to adequately recover the costs passed through by networks and explain year-on-year variations to customers.

The AEC notes that recent academic research into the NSW Electricity Infrastructure Roadmap, which uses a similar cap and collar scheme, suggests it is leading to higher energy bills for customers, with disproportionate impacts to disadvantaged groups.

Given the limited time to test the rigour of the cost recovery process, this increases the need for a review trigger to be included in the regulations.

Any questions about this submission should be addressed to Rhys Thomas, by email Rhys.Thomas@energycouncil.com.au or mobile on 0450 150 794.

Yours sincerely,

Rhys Thomas
Policy Manager
Australian Energy Council

Level 13, 575 Bourke Street
Melbourne 3000
GPO Box 1823 Melbourne Victoria 3001

P +61 3 9205 3100
E info@energycouncil.com.au
W energycouncil.com.au

ABN 92 608 495 307