NEM Review Secretariat

Submitted via email: nemreview@dcceew.gov.au

17 September 2025

National Electricity Market wholesale market settings review – Draft Report

The Australian Energy Council ('AEC') welcomes the opportunity to make a submission to the Expert Panel's Draft Report.

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.

Overall views on the Draft Report

The AEC welcomes the Expert Panel's Draft Report, and in particular the extensive engagement they have led with industry stakeholders. We support the Expert Panel's overall approach – to encourage a market-led, NEM-wide approach to incentivise efficient investment in the energy services required for the energy transition. We believe the Expert Panel's proposed solutions are well considered and offer the sector the opportunity to transition at least-cost to consumers.

We support the key elements of the Panel's proposals, including the intent to leverage existing market mechanisms, including the spot market, the integration of the Electricity Services Entry Mechanism (ESEM) with the NEM, defining the key energy services required, and the focus on better coordination of Essential System Services (ESS) procurement.

We are engaged with the Expert Panel on fleshing out the detailed design of the Draft Recommendations and will continue to engage over the coming months. We support the industry collaboration the Expert Panel has fostered to this point and see an ongoing need for this to continue. As the detailed design decisions are made, a more formal stage of industry consultation is warranted. In particular, the AEC recommends:

1. Another round of public consultation on the full suite of reforms

The Draft Report has set out the conceptual framework, but there is still significant detail to be worked through – for example, the laws and rules surrounding contract options, potential changes to market settings, and governance of the ESEM. These design features will all substantially influence the workability and practical impacts of the reforms proposed.

Given the magnitude of the reforms, taking a further 3-6 months to achieve this would be prudent, and is unlikely to undermine timely implementation. Making use of this extra time to engage with industry on the final recommendations would increase confidence in the overall process and reduce the effect of unintended consequences that can arise when introducing major reforms. We would anticipate that once the Final Report is drafted and socialised with market bodies and jurisdictions, the Expert Panel and NEM Secretariat could run a process where industry can review the final recommendations and provide its feedback. This could inform both

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

modifications to the Final Report and jurisdictional assessment of the merit of the proposed reforms.

Undertaking additional targeted consultation is preferable to relying on feedback via Exposure Drafts consultation, as there is less scope for genuine reform once the laws are drafted. Furthermore, we understand the implementation of the Draft Recommendations will likely involve a mix of NEL and NER changes, as well as substantial work in developing guidelines. It will likely also involve substantial work to support good governance and risk management around the body appointed as the ESEM administrator.

2. Convene an industry "paper trial" exercise to test the proposed design

Once the Expert Panel has a close to final view on the detailed design of the relevant contracts, ESEM and MMO, it should convene an industry "paper trial" exercise, similar to what was performed at NEM market start. This would involve bringing together all relevant market participants, Government and market bodies to stress test how the underpinning contract structures and policy designs would work in practice under a range of scenarios.

The remainder of this submission focuses on the core proposals the Expert Panel has recommended – the ESEM, the MMO and the underlying derivative contracts contemplated.

Electricity Services Entry Mechanism

The AEC supports the Panel's proposal to establish the ESEM. If designed effectively, the ESEM should incentivise investment in assets that can deliver the services that the market needs while also encouraging these new assets to participate fully in both the physical and financial markets.

Additional policy work is required to clarify how the ESEM will operate and what the governance arrangements are for the ESEM administrator. Our thoughts on some of the key design elements are outlined below:

- Balanced Target Setting and Preventing Oversupply: We recommend that ESEM targets be based on the National Electricity Objective (NEO) and a codified, transparent process. The targets set for bulk, shaping and firming services must be carefully balanced with the need to support revenue adequacy and efficient markets for all electricity service providers, both new and existing. There is a risk that the ESEM could cause oversupply in new generation, undermining revenue adequacy for essential existing capacity and necessitating reliance on interventions, which would further distort investment signals. We are keen to better understand whether State Governments will have a role in determining ESEM targets for their State, how State based obligations would be incorporated into the ESEM framework, and whether plant refurbishments and expansions would be able to participate, particularly where there are opportunities to leverage existing plant at a lower cost than new projects.

- Clear Governance and Administrator Role: The governance structures for the Capacity Investment Scheme (CIS) and NSW's Long-Term Energy Services Agreements (LTESA) are confused and unnecessarily complicated with ASL (formerly AEMO Services) performing some roles but contracting and risk sitting with DCCEEW and the Scheme Financial Vehicle (SFV) respectively. A single body with appropriate commercial and risk management skills should administer the ESEM, with clear statutory objectives guiding

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

its operation, including promoting the construction of the right mix of assets and minimising costs to consumers.

An area that requires further work is the proposed contract recycling mechanism. Clarity is needed on ESEM auction frequency, covered periods, information publication, and the administrator's discretion regarding proposal assessment (price, technology mix, delivery risk, ability to decline offers or contract higher volumes). The ESEM administrator's risk management mechanisms need to be defined, including its ability to restructure products, trade in other instruments, and hold contracts longer or to maturity if market value is unfavorable.

- Industry-Led and Flexible Contract Co-design: A strong industry-led co-design process is essential for the ESEM and Market Making Obligation (MMO) to succeed, ensuring developed contracts are relevant to market needs and can evolve without constant government intervention.

  We do not consider the AER to be well placed to coordinate the co-design process due to its limited knowledge of the financial market or experience operating in it. The ESEM administrator, by its nature of market participation and financial expertise, is better placed to coordinate an industry-led, pragmatic commercial process. The AEC would expect that the ESEM staff would predominantly have a commercial rather than regulatory background.

- Technology-Specific Support: The AEC recognises that certain technologies (eg. Offshore wind, pumped hydro, bioenergy-fueled generation) are likely to face barriers beyond the tenor gap. It is important that support is directed to investments that are consistent with supporting reliability standards and their ability to support emission reduction.

- Firming Interim Solution: Given the significant procurement lag and the lack of support under the Capacity Investment Scheme, the Panel should consider whether aspects of the ESEM could be fast-tracked to ensure timely deployment of gas-fired and hydro assets required to maintain reliability and support increasing Variable Renewable Energy (VRE).

- Market Share and Competition: We caution against implementing rigid caps on the volume of services individual participants can provide based on market share, as this risks excluding efficient, low-cost providers and increasing customer costs. Alternative requirements for large players, such as participation through ring-fenced entities or special purpose vehicles, could balance competition and market power concerns. The ESEM administrator would also recycle contracts entered into with new projects back to the market to support liquidity, so it's not clear what risk this is intended to address.

- Investment support: To better support investment in plant, we think the ESEM will need to focus on how best to address revenue adequacy issues.

Essential System Security (ESS) and the ESEM

The AEC acknowledges the Expert Panel's draft recommendations in relation to Essential System Security Services and we support the idea of better coordination of Essential System Services

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

(ESS) procurement with the ESEM. However, the recommendation should go further towards fostering a market-based, least-cost procurement model for ESS as thermal plant closes.

The Panel's proposal still relies on TNSP-led procurement, which tends to favour more expensive network options over non-network options.

- It strengthens TNSPs' incentives to meet system strength requirements through additions to regulated asset bases, in the form of new synchronous condensers, which can increase costs for consumers.
- It places TNSPs in the privileged and somewhat conflicted position of having access to, and ultimately making recommendations between, third party system strength offerings and their own direct investments in network assets.
- These outcomes could be avoided through the creation of a market to procure system strength, rather than reliance on TNSP-led contracting.

To support more efficient outcomes, visibility of ESS requirements and costs should be improved, procurement processes be expedited, and longer ESS contract terms be offered. 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. Given that regulatory processes for ESS can experience delays, there may be a need for a more expedited process for procuring ESS as part of the ESEM compared to existing RIT-T and other TNSP processes. This could be achieved by setting criteria, including target prices, and permitting procurement where it is more efficient than TNSP-led, network-based solutions. The term for ESS contracts should align with ESEM contracts, as longer-term contracts are needed to support new investment for services like system restart, system strength, and inertia, which are no longer mere by-products of generation.

The ESEM will need to ensure sufficient replacement resources are procured and available prior to large generation units ceasing operation, requiring an overlap to ensure continuity of system reliability and security. The firming service requirement should be established before other services, as it is most crucial to reliability. It could be set based on the level required to ensure unserved energy is below the target and account for reasonable "dunkelflaute" risk.

Mandatory Market Making Obligation

The AEC plans to respond to the Expert Panel's detailed paper on Market Making Obligations, so our comments here are more high-level observations:

- MMO Suitability and Design: We support the intent to increase liquidity and forward price transparency. However, a mandatory MMO is not well-suited to addressing liquidity concerns primarily caused by increasing VRE, which often stem from physical constraints rather than market power. The ESEM, by targeting the underlying supply issue, is better placed to improve liquidity in such cases. If implemented, the MMO should be appropriately targeted and not impose unreasonable risks on participants, with reasonably wide buy-sell spreads and low mandatory offer requirements.

  Circuit breaker mechanisms are necessary to protect market makers during periods of high volatility, drawing on lessons from New Zealand. Clarity is needed on who the MMO will apply to, the classes of products, volumes, spreads, periods, trading windows, and incentives for market makers. These requirements should reflect market maker

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

portfolios and be dynamic. The regulatory regime should not limit the ability of the co-design process to designate OTC products as MMO products.

If there is evidence an MMO is required, the design should ensure the obligations are only imposed on the products and regions where this intervention is required (e.g. where liquidity in core products is below a defined threshold). The framework should be sufficiently flexible so as not to result in market makers having to take sub-optimal risk positions and potentially impede their ability to efficiently manage their own customer demand.

- MMO and ESEM Contract Distinction: The Panel should clarify that ESEM and MMO contracts need not necessarily be the same. While MMO products may benefit from being listed and fungible, these characteristics may be less relevant for ESEM products, and required tenors will likely vary. We consider any MMO should initially only capture the core contracts currently utilised by market participants to hedge financial risk (i.e. swaps and caps). This is a prudent approach that would allow sufficient time for any new products identified through the co-design process to be developed and listed on an exchange, with the suite of MMO products then potentially expanded beyond swaps / caps over time should a market for the new products develop as intended.

- Commercial Market Making: A commercial market making framework could be implemented to support trading of the new contract-types, noting voluntary / incentive-based frameworks are more likely to result in the most efficient market-makers being appointed (i.e. those best placed to provide the service at least cost for the market / consumers).

- Inter-Regional Hedging (IRSRs): Strong inter-regional hedging is required to encourage investment in VRE and maintain liquidity as the proportion of VRE increases. We support extending the timeframe for inter-regional settlement residue units beyond three years. We anticipate that this would encourage contracting over a longer-time frame, noting that if there is lower demand for a longer timeframe (as there is for the later quarters in the current 3-year duration) the price will close at a lower price, allowing participants to access hedging at a lower cost (as a trade-off for lower price certainty).

  Consistent with the above, we support the Panel's recommendation to undertake a review to ensure that long-term hedging across interconnectors can be done in a manner that allows for contractual certainty.

  However, we are concerned that the "netting off" approach proposed in the AEMC's recent Directions Paper regarding allocation of negative IRSRs in transmission loops, directly conflicts with the important role settlement residue auction (SRA) units would play in a high VRE system. We consider that the change would both devalue SRA units and make residues very difficult to predict. This would nullify the use of IRSR as a hedging instrument and its important role in supporting retail competition. While this rule change is outside the scope of the review, to support IRSR continuing to play the important role envisaged in the draft report, we recommend that the proposed netting off approach is not implemented.

- Retailer Reliability Obligation (RRO): We support repealing the RRO when the ESEM and MMO are introduced. The RRO is a deeply flawed mechanism that has not led to greater investment in firming capacity, and its repeal will simplify the operation of the new MMO.

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

Spot market observations

The AEC supports the Panel's findings that an energy only spot market has served the NEM well and remains fit for purpose as the energy transition continues. We offer the following observations:

- Rebidding and Algorithmic Bidding: We caution against imposing limits on rebidding and algorithmic bidding that undermine market efficiency. Algorithmic bidding can enhance market efficiency by enabling faster, data-driven decisions, reducing transaction costs, and promoting competition. Any regulatory response should be balanced against the risk of deterring participation of flexible resources and should promote competitive markets rather than restricting algorithmic bidders. We recommend leveraging industry experience in further investigation of potential risks and resolutions. We consider the AER the appropriate regulator to examine these issues in more detail.

- Price-Responsive Resources Visibility and Dispatchability: We support the integration of price-responsive resources into the NEM. However, obligations for these resources to be visible or dispatchable should be proportional to their potential impact on market outcomes and balanced with the commercial implications of compliance. We recommend extensive consultation on appropriate thresholds for mandatory participation and that consumer choice and competitive markets remain central to decision-making to avoid dissuading participation. It is premature to mandate these things before knowing how they work, as existing frameworks are not fully implemented and further data is needed.

  A prudent pathway forward would be for the Panel to recommend a review of the Integrating Price Responsive Resources (IPRR) framework in 2030. By that time, there would be over two years of operational experience and reporting data (including in relation to the impact of unscheduled price responsive resources (PRR) on forecast deviations) to assess, which could in turn support more targeted / tailored solutions to improve the visibility of resources if necessary.

Out of market reserve mechanism

The AEC is concerned that an out of market reserve mechanism could impact NEM market outcomes and be an expensive form of insurance. The NEM already has a similar mechanism - the Reliability and Emergency Reserve Trader (RERT) and it has proved to be expensive for consumers. If an out of market reserve was implemented, it should not undermine in-market incentives for long duration assets like hydro which are critical to the energy transition.

Given an out of market reserve would be targeted at assuring reliability outcomes above the reliability standard, it essentially would act as a form of insurance for Energy Ministers over and above the efficient level that consumers should bear. It follows that to the extent this mechanism was triggered the cost should be funded through Consolidated Revenue of the relevant jurisdiction. This would help manage the risk that an out of market reserve is called upon more often and for a wider range of reasons than initially anticipated.

The Panel's discussion of an out of market reserve service is noted as potentially useful for jurisdictions to mitigate reliability risks from high-impact, low-likelihood events while

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

quarantining these investments from market disruptions. However, to ensure it doesn't interfere with market dynamics, it should only be used when there is a clear need and not as a substitute for assets participating in the NEM. Strict limits should apply, activating it only when a capacity shortfall is forecast, and market-based assets have been exhausted. Strong governance and transparency are recommended to bolster system reliability without compromising market integrity.

The AEC looks forward to continuing to engage with the NEM Expert Panel on the design of the final recommendations and appreciates the efforts taken to date to work with industry and other stakeholders.

Any questions about this submission should be addressed to David Feeney, by email David.feeney@energycouncil.com.au.

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