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Australian Energy Market Commission

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Consultation paper – ECGS Supplier of last resort mechanism

AGL Energy (**AGL**) welcomes the opportunity to provide this submission in response to the Australian Energy Market Commission (**AEMC**) consultation paper concerning the east coast gas system (**ECGS**) supplier of last resort (**SoLR**) mechanism.

Key points

- **The SoLR mechanism creates risks of moral hazard and market instability**
  The design of the mechanism may reduce incentives for market participants to secure firm supply and hedging arrangements. This could lead to weaker contracting practices, discourage investment in gas production, and increase the likelihood of emergencies and higher costs for consumers.

- **Market participants are best placed to manage reliability and supply adequacy risks**
  Competitive market responses provide flexibility and innovation and can often eliminate the need for intervention. Where gaps exist, adjustments to existing market arrangements should be considered to strengthen market-led solutions and reduce reliance on AEMO intervention.

- **The need for a SoLR mechanism is not explained and the design is unclear**
  The paper does not identify scenarios where AEMO could intervene effectively while market participants cannot. It also lacks clarity on the purpose, scope, and sequencing of key elements such as preconditions, triggers, and reserves. This ambiguity undermines transparency and predictability.

- **AEMO should focus on actions that market participants cannot undertake, such as demand response**
  The core issue the SoLR mechanism seeks to address is the increasing risk of peak day and structural gas shortfalls. Acting as a market participant by buying or selling gas does not increase supply. Demand response is the most logical intervention because it targets consumption when supply cannot meet demand.

The SoLR mechanism risks creating moral hazard and increasing market instability

We acknowledge the policy intent behind the proposed the SoLR mechanism is to provide a safeguard during genuine gas shortfall emergencies. However, we consider its design may unintentionally reduce incentives for market participants to responsibly and prudently manage their exposure to the gas markets . This would increase the probability and severity of adverse outcomes in the gas markets.

The Stage 1 and Stage 2 Reliability and Supply Adequacy (**RSA**) reforms were introduced in response to the winter 2022 energy crisis. Market conditions were challenging at that time, and the impact on some end

users, particularly manufacturers, was severe.[1] However, market participants with firm supply and haulage contracts were largely protected from undersupply risks and the extreme spot prices across the gas markets. This demonstrates the importance of robust contracting practices in maintaining secure gas supply and managing risk effectively.

The SoLR mechanism would provide support to parties that have not secured firm volume and price contracts or appropriate financial hedging arrangements. This creates a moral hazard because some participants may choose to contract less or avoid hedging, based on the expectation that AEMO will intervene during periods of tight supply and high prices. This behaviour reduces incentives for longer-term contracting, which in turn discourages producers from investing in exploration and development.

Although the mechanism is intended as an emergency measure, it risks increasing the frequency of emergencies by weakening these contracting incentives. In effect, it could exacerbate the very problem it seeks to solve, leading to more interventions and ultimately higher costs for consumers.

Market participants are best placed to manage reliability and supply risks efficiently

Market participants are best placed to respond to risks to reliability and supply adequacy in the most timely and cost-efficient manner. Competitive market responses allow flexibility and innovation, and they can eliminate the need for intervention. Where gaps exist, changes to existing market arrangements should be explored to better equip participants to respond effectively. This approach would further reduce the need for AEMO intervention and preserve the integrity of market-based outcomes.

The AEMC's consultation paper does not appear to describe the types of scenarios in the ECGS where market participants would be unable to respond, but AEMO would be able to intervene effectively. This analysis is necessary to justify the introduction of a SoLR mechanism and to ensure that any intervention is proportionate and targeted.

If a SoLR mechanism were to be implemented, it must be designed so that any action taken by AEMO is predictable, market participants receive sufficient prior notification, and intervention occurs only when no other viable options exist. This approach would reflect the instructions of Energy Ministers by ensuring the mechanism truly operates as a last resort.

AGL notes that the AEMC is considering incorporating demand response within the SoLR mechanism. Unlike supply-side measures, AEMO may be uniquely positioned to operate demand response. The core issue the SoLR mechanism has been designed to address is the increasing risk of peak day and structural gas shortfalls in the ECGS. If AEMO participates in the market as if it were a market participant by buying or selling gas, storage, or other services, this does not increase the volume of gas available to the domestic market. AEMO should focus on actions that market participants cannot undertake. A demand response mechanism targets the one area AEMO can influence: consumption. In a situation where supply cannot meet demand and there is no clear plan to increase gas production, reducing demand may be the only remaining option to avoid shortfalls.

It is unclear how the proposed SoLR mechanism will address the problems identified in the rule change request

The AEMC has identified the following three parts to the problem the rule change process should address:

1. Risks of peak day and structural gas shortfalls in the ECGS
2. The need for guidance and guardrails for AEMO's exiting ECGS trading function

[1] The ACCC's Gas Inquiry Report of July 2022 provides a detailed account of the experiences of some commercial and industrial customers – see section 3.3 'diversification of user portfolios/options' p.60.

3. The need for an enduring solution for Victoria's Declared Wholesale Gas Market (**DWGM**) Dandenong LNG (**DLNG**) storage facility

The rule change proposal attributes forecast gas shortfalls to increased demand for gas-powered generation in the National Electricity Market, with risks most acute during winter in southern jurisdictions. Declining gas production is also noted as a contributing factor.

AGL does not consider the proposed SoLR mechanism to be an effective or practical tool for managing these drivers of forecast gas shortfall risks. The consultation paper does not demonstrate how the mechanism would address these underlying issues.

Energy Ministers identified several key issues with the existing trading function provisions in Part 27 of the National Gas Rules (**NGR**). These issues included:

- a lack of clear and objective guidance to AEMO and market participants on when and how the function should be exercised
- inadequate guardrails around the use of the function, particularly given its potential to:
    - impose unnecessary costs on gas users
    - give rise to a perceived conflict of interest for AEMO in the facilitated markets if AEMO is competing with market participants to procure gas or other services
    - have a range of distortionary market impacts, including potentially crowding out market participants and reducing their incentive to address the threats

AGL agrees these issues should be resolved. However, the options outlined in the consultation paper do not appear to address them. For example, under the proposed SoLR mechanism, guidance for AEMO and market participants remains unclear, subjective and unnecessarily complex. Further detail around our concerns with the proposed mechanism are outlined later in this submission.

AAGL considers it may not be appropriate for the AEMC to identify the need for enduring arrangements for the DWGM DLNG storage facilities as part of the problem this rule change process seeks to address. Energy Ministers explicitly stated in their rule change request that it does not seek to amend the DLNG last resort mechanism. While we acknowledge that it may be sensible for this consultation process to consider interactions with the DLNG arrangements for future design purposes, this rule change process should not extend to deciding on or amending those arrangements. Maintaining this distinction is essential to ensure governance clarity and avoid conflating separate rule-making processes.

Clarification is needed on the purpose, scope and sequencing of key elements of the SoLR mechanism

The consultation paper explores a range of options to help address the existing lack of clear and objective guidance and guardrails. We acknowledge the challenges of addressing each of these elements in detail, particularly when the detailed design and the inclusion of particular components in the final SoLR framework remain uncertain.

It has been challenging to understand detail of the individual options, how they may interact with each other and their sequencing in the overall structure of the SoLR mechanism. This has made it difficult to provide sufficiently informed and considered feedback.

These difficulties appear to stem from inconsistencies in terminology and definitions, both within the consultation paper and between the paper and the Energy Ministers' rule change request. To illustrate these concerns, we have provided examples focused on decision-making requirements and the need for clear and objective guidance and guardrails. These examples are not exhaustive but highlight areas where clarification would be most valuable.

Example 1 – Scope and application of SoLR principles

The consultation paper asks stakeholders whether mandatory or discretionary principles (**SoLR principles**) should be developed to guide AEMO's use of a SoLR mechanism.[2] In contrast, the Energy Ministers' rule change request states that AEMO is to have regard to these principles when establishing or using a SoLR reserve.[3]

This difference creates uncertainty about whether the AEMC considers the *use of the SoLR mechanism* and the *establishment or use of a SoLR reserve* to be the same concept or distinct processes. This distinction is important because it affects when and how the SoLR mechanism could be exercised.

We suggest the AEMC clarify the intended scope and application of these principles and confirm whether any changes from the Energy Ministers' proposal are intended. Clear guidance on this point will help stakeholders understand the operational framework and provide informed feedback.

Example 2 – Design and purpose of preconditions and trigger

The Energy Ministers' rule change request states that the SoLR mechanism should "operate in a transparent and predictable manner by specifying clear and objective preconditions for triggering this mechanism."[4] Table 1.1 in the rule change request shows the preconditions for triggering the SoLR mechanism at the start of the operational sequence and separate from the establishment of a SoLR reserve and the use of a SoLR reserve each of which are presented as two distinct elements. This suggests that the preconditions for triggering the SoLR mechanism are intended to form a single combined element at the start of the sequence, separate from later elements including decisions to establish or use a SoLR reserve.

In contrast, the consultation paper appears to explain these elements differently. The preconditions are described as "requirements that must be met before AEMO can consider whether to create a reserve for a SoLR mechanism"[5] and defines the trigger as "the decision point for AEMO on whether to use a reserve it has established."[6] This implies that AEMO could establish SoLR reserves prior to triggering the SoLR mechanism being triggered.

This creates ambiguity regarding the intended purpose and operational sequence of the SoLR mechanism, as well as the relationship between the preconditions, triggering, and the establishment and use of SoLR reserves. Clear guidance on these points is essential to ensure stakeholders can accurately assess the design, understand when intervention may occur, and confirm that the mechanism aligns with its stated objectives of transparency, predictability, and efficient market operation.

Also, it would be helpful for the AEMC to explain its intentions around whether:

- the SoLR mechanism can be triggered independently, without necessarily leading to the establishment or use of a SoLR reserve
- AEMO's interventions under the SoLR mechanism are intended to be limited exclusively to actions related to establishing or using a SoLR reserve

We have provided comments in response to several consultation paper questions in the appendix below. This feedback is intended to assist the AEMC as it undertakes further detailed design work.

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[2] AEMC, Consultation Paper, section 4.2, p. 19
[3] Energy Ministers' Rule Change Request, section 3.3.1, pp. 33–34
[4] Energy Ministers, Rule Change Request, Table 1.1, p. 13
[5] AEMC, Consultation Paper, section 5.2, p. 28
[6] AEMC, Consultation Paper, section 5.3, p. 33

At this stage, AGL has not formed a view on whether it should support the introduction of the SoLR mechanism. Before a position can be determined, the discrepancies between the Energy Ministers' rule change proposal and the consultation paper, together with other key design issues outlined in this submission, need to be clarified and resolved. Clear alignment on these matters is essential to ensure transparency, predictability, and confidence in the mechanism's design.

We would be happy to discuss our submission in more detail with the AEMC if this would be useful. Please contact Warren Vosper at wvosper@agl.com.au.

Yours sincerely,

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Appendix – Responses to the AEMC's consultation questions

Question 3: Principles to guide AEMO's use of a SoLR mechanism

- AEMO should be required to apply the SoLR principles whenever it establishes or uses a SoLR reserve.
- These principles must be mandatory and not left to AEMO's broader discretion.

Question 4: Services AEMO could procure through a SoLR mechanism

- AGL notes that the rule change request proposes SoLR reserves in relation to both services and products.
- We also note that the consultation paper does not reference the guardrails requested by Energy Ministers for the Storage SoLR Reserve. These guardrails require that the relevant forecast breach be identified with at least eight weeks' notice and that the breach is forecast to persist for more than four weeks or occur on multiple occasions over a period of at least four weeks.
- We strongly recommend that these requirements not be removed.

Question 5: Constraining AEMO's SoLR costs

- The AEMC's preliminary direction is that a willingness to pay (**WTP**) measure should be used to constrain the amount paid by AEMO, ensuring it does not spend more than customers are willing to pay for reliability and supply adequacy.
- This approach raises an important question. If the SoLR mechanism is intended to operate strictly as a last resort, consistent with the intent of Energy Ministers, how could a situation arise where market participants, when faced with a risk of a gas supply shortfall, are unwilling to take actions that cost at or below their willingness to pay?
- This scenario seems unlikely, and counter intuitive. However, based on what is proposed, it appears to be the only scenario in which AEMO would be able to act under the SoLR mechanism (with the exception of demand response actions). This presents two concepts that warrant further consideration.
- First, if this is the scenario we are planning for and we agree it would never occur, then there may be no need to implement a SoLR mechanism. This would support the view expressed by AGL that market participants are best placed to respond to reliability and supply adequacy risks in the most timely and cost-efficient manner.
- Second, it suggests that AEMO would only ever need to intervene when the cost of that action exceeds what customers are willing to pay for reliability and supply adequacy. If this is the intent of the AEMC and Energy Ministers, then it should be stated clearly as part of the public consultation process.
- The objective of constraining AEMO's costs becomes more challenging and complex when considered alongside another related aspect of the rule change request. In order to avoid any actual or perceived conflict of interest, the proposal requires that if AEMO procures gas from the DWGM or Short Term Trading Market (**STTM**), it must submit bids to withdraw gas at the applicable market price cap. For this to be possible, the WTP would need to be at least $800/GJ.
- The consultation paper notes that the market price cap in the DWGM, known as the value of lost load (**VoLL**), is currently $800/GJ. If a single willingness-to-pay measure is intended to apply across the entire ECGS, it would need to be set at least at this level to enable AEMO to bid at the market cap in both the DWGM and the STTM, where the cap is $400/GJ.
- Further comments on the AEMC's proposal to introduce a WTP are set out in our submission to the AEMC's directions paper of August 2025 on the ECGS Reliability standard and associated settings.

Question 6: Geographic and seasonal scope for a SoLR mechanism

- Limiting the geographic scope of a SoLR mechanism to the southern jurisdictions of the ECGS would introduce operational and functional challenges that could increase the risk of market disruption. These risks would be significantly reduced if the mechanism applied across the entire ECGS.
- Similarly, restricting the seasonal scope to winter would create comparable challenges and increase the likelihood of disruption. Applying the mechanism year-round would provide greater flexibility and reduce these risks.

Question 7: Existing preconditions and triggers for AEMO intervention

- We agree that there are issues with the existing arrangements for AEMO's trading function that should be addressed.
- However, the consultation paper notes that the current rules require industry to be given a reasonable period of time to take action to mitigate an identified risk or threat before AEMO intervenes. This principle does not appear to be included as part of the proposed SoLR mechanism.
- Retaining this requirement is important to support market-led responses and minimise unnecessary intervention.

Question 8: Using a risk or threat signalling framework as a precondition

- The consultation paper notes that a risk or threat signalling framework that uses tiers (to communicate the level, or severity of a risk) and a probabilistic metric (to indicate the likelihood of a risk happening) could be part of the preconditions for AEMO to procure a reserve under a SoLR mechanism. This approach is suggested due to two gas system-specific features:
    - the temporal separation between supply decisions and demand fulfilment
    - the possibility of location specific shortfalls
- However, the illustrative example provided in the consultation paper does not appear to incorporate information relevant to either time or location.
- We also note that the example labels the "level 1" risk as "early warning." This terminology may cause confusion because the word "early" introduces a time-based element to what should focus solely on severity. While severity can change over time, the relationship is not certain. A risk may increase, decrease, or remain stable over time, and severity can also change due to other factors such as the size of a potential shortfall.
- While a signalling framework may have an important role alongside other elements of the SoLR mechanism, we encourage the AEMC to explore options for communicating time and location information in a way that enables timely and efficient market responses and reduces the likelihood of AEMO intervention. Clear and actionable signals will help support market-based solutions and maintain confidence in the mechanism's transparency and predictability.
- We note that shifting from a reliability standard to a risk or threat signalling framework may represent a fundamental change from a binary trigger to a probabilistic one. Under a reliability standard, a breach would either be forecast to occur or not, providing a clear signal to market participants and AEMO about when actions under the SoLR mechanism can be taken.
- In contrast, it is unclear what conditions under the proposed signalling framework would serve as a threshold that, if met or exceeded, would provide an equivalent level of certainty. Clear thresholds are essential to maintain predictability and confidence in the mechanism.
- We recommend the AEMC provide more detail on its intended use of a risk or threat signalling framework that reflects the intent of Energy Ministers and provides clarity to the market. For example, limiting intervention to circumstances where a forecast shortfall is certain would achieve this objective.

Question 10: AEMO's discretion under a trigger mechanism

- The SoLR mechanism should never be enacted automatically under any circumstances.
- For the SoLR mechanism to be enacted, it must be initiated through AEMO's discretionary decision-making.
- The circumstances in which AEMO may exercise this discretion must be objective, transparent, and predictable, and AEMO must provide prior notice to market participants with sufficient time for a market-led response to the gas shortfall risk.

Question 11: The trigger for contingency gas in the STTM

- The trigger to use contingency gas in the STTM should be separate and mutually exclusive from the SoLR mechanism in the ECGS.
- The introduction of a SoLR mechanism does not create a need to define an order of priority for market intervention tools. By name and intent, the SoLR mechanism is a mechanism of last resort. AEMO must only be able to act under the SoLR mechanism if no other viable options are available, including those provided under the contingency gas arrangements in the STTM.
- Energy Ministers have clearly stated that the proposed rule change is not intended to affect the operation or use of any other RSA management tools available to AEMO, including the market-specific tools in the DWGM (the DWGM intervention power) and the STTM (the contingency gas mechanism).

Question 12: The trigger for intervening in the DWGM

- The trigger to intervene for system security reasons in the DWGM should not be amended if a SoLR mechanism is introduced.

Question 17: Buying and selling gas through facilitated markets

- The consultation paper states that AEMO should bid at the market price cap when procuring gas (withdrawals) from the DWGM and STTM. This is intended to prevent AEMO's bids from interfering with participant bidding, reduce the likelihood of crowding out and avoid any actual or perceived conflict of interest (or unfair advantage). The paper further asserts that this approach would achieve these outcomes because other bids would clear first under normal market conditions and that it would be consistent with the last resort nature of the function.
- However, this assertion does not reflect how withdrawal bids clear in the DWGM and STTM. Withdrawal bids clear in descending price order, meaning the highest-priced bids clear first. If AEMO bids at the market price cap, its bids would clear ahead of all others, not last. In effect, AEMO would become a primary buyer rather than a buyer of last resort, securing gas before, for example, a manufacturing plant willing to pay $15/GJ or a retailer willing to pay $20/GJ. This could lead to allocative inefficiency.
- The consultation paper also claims the proposed approach aligns with the DLNG arrangements, where AEMO is required to submit injection bids at the market price cap. This comparison is not accurate. The DLNG arrangements involve injection bids, which represent offers to supply gas into the market. Injection bids clear in ascending price order, meaning the lowest-priced bids clear first and the highest-priced bids clear last. By requiring DLNG injection bids to be priced at the market price cap, those bids only clear after all other injection bids. In contrast, requiring SoLR withdrawal bids to be priced at the market price cap would have the opposite effect.
- If the AEMC intends to replicate the approach and stated benefits of the DLNG arrangements for withdrawals, bidding at the market price floor would be a closer parallel.
- We recommend that the AEMC clarify whether bidding at the market price cap for withdrawals is the most appropriate approach, or whether an alternative such as bidding at the market floor would better align with the principles and objectives outlined by Energy Ministers.

- The consultation paper also addresses how AEMO should supply gas from its storage reserve by selling this gas through the facilitated markets. The proposal would require AEMO to price any gas that is placed in a pricing or operating schedule at the market price cap.
- For the reasons highlighted above, we acknowledge that by requiring AEMO injection bids to be priced at the market price cap, these bids would clear only after all other injection bids. Compared to the proposed approach for withdrawal bids, this approach would be more likely to minimise instances of AEMO's bids interfering with participants' bids and crowding out the market.
- We recommend that the AEMC clarify whether bidding at the market price cap for withdrawals is the most appropriate approach, or whether an alternative such as bidding at the market floor would better align with the principles and objectives outlined by Energy Ministers.

Question 18: Role of demand response in gas market arrangements

- Whether gas users respond to prices in the STTM or DWGM depends on their exposure to these prices and the flexibility of their demand.
- When tight supply and demand conditions lead to high market prices, gas users that have submitted price-sensitive withdrawal bids will automatically reduce demand if the market price exceeds their bid price. This is already a normal feature of the market and does not require the introduction of a separate gas demand response mechanism.
- However, under the same conditions, demand is unlikely to change for gas users that have submitted bids at the market price cap. These bids reflect a willingness to purchase gas at any price up to the cap. Introducing a demand response mechanism to reduce the demand of these users could result in significant operational and economic impacts, particularly for industries that rely on continuous gas supply.
- The overwhelming majority of gas in the ECGS is procured under long-term bilateral GSAs, which limits exposure to short-term price spikes for many participants.
- Industrial and large-scale users generally have limited ability to reduce consumption due to operational requirements that necessitate consistent gas volumes and continuous flow, regardless of price fluctuations.

Question 35: Changing the Dandenong LNG interim arrangements

- We recommend removing the DLNG interim arrangements, irrespective of whether a SoLR mechanism is introduced.
- If the AEMC decides to introduce a SoLR mechanism, it should apply consistently across the ECGS without requiring unique arrangements for DLNG. Consistency will help maintain transparency, predictability, and simplicity in the market design.

About AGL

At AGL, we believe energy makes life better and are passionate about powering Australian life. Proudly Australian since 1837, AGL delivers around 4.6 million[7] gas, electricity, and telecommunications services to our residential, small and large business, and wholesale customers across Australia. AGL operates Australia's largest private electricity generation portfolio within the National Electricity Market, comprising coal and gas-fired generation, renewable energy sources such as wind and hydro, and batteries and other firming and storage technology. We are building on our history as one of Australia's leading private investors in renewable energy to be a leader in the transition to a lower emissions and smart energy future in line with the goals of our Climate Transition Action Plan. We'll continue to innovate in energy and other services to enhance the way Australians live, move and work.

[7] Refer to AGL's ESG Data Centre FY25