

14 July 2025

SA Department of Energy and Mining

Submitted online



Firm Energy Reliability Mechanism – Stage 2

The Australian Financial Markets Association (AFMA) is responding to the South Australian Department of Energy and Mining's (DEM) Stage 2 consultation on its proposal for a Firm Energy Reliability Mechanism (FERM).

AFMA is the leading financial markets industry association promoting efficiency, integrity and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, environmental, carbon, and other specialist markets. Our membership base is comprised of over 130 of Australia's leading financial market participants, including many energy firms who are key participants in the NEM.

Key Points

- **FERM should be designed to work with the recommendations of the NEM Market Settings Review**
 - **It is unclear why FERM needs to support long-duration firm capacity after the commencement of the NEM Market Settings Review's recommendations**
 - **Units that do not receive payments under FERM should only be required to advise if they intend to close during the commitment period and should not be required to give a capacity commitment**
 - **The proposed Reliability Obligation is unnecessary**
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Ensuring the NEM has adequate firming resources to support the increasing volumes of variable renewable generation required for the net-zero transition is one of the key challenges facing the market. Solving this challenge in a timely fashion is particularly important for South Australia, which has some of the highest levels of variable renewable generation globally. While we appreciate South Australia's desire to implement FERM quickly, particularly to support existing assets, we think any intervention should be designed to be consistent with the recommendations of the NEM Wholesale Market Settings Review (NEM Review) and any support for long-duration firm capacity should be designed to allow it to be rolled into the national framework.

1. NEM Wholesale Market Settings Review

1.1. Overlap with the Review

Since the stage 1 FERM consultation it has become clear the NEM Review Panel's draft recommendations will include mechanisms to promote investment in new intra-day shaping and long-duration firming capacity. These recommendations will clearly overlap with the proposals for long-duration firm capacity under FERM. At a very high level, the main differences between the two reforms are that FERM is intended to commence before the NEM Review Panel's work and will also support existing generation.

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While we appreciate South Australia's desire to have FERM commence before changes to the national framework, it is unclear to us what role the FERM long-duration firm capacity incentives will play once national arrangements are in place and how the two schemes are intended to operate together. We would appreciate clarity about why South Australia think these incentives should continue to operate once national arrangements are in place and details about how the two schemes are expected to operate together. In particular, given that the Notice of Intention and Capacity Commitment obligations will apply to all assets in South Australia, it is unclear to us why these obligations should apply to assets funded entirely under the national framework.

1.2. Contract structures

AFMA supports DEM's proposal to give the Scheme Administrator greater flexibility about how it contracts with existing units. We consider that this is appropriate as the commercial needs of existing units are likely to differ and it is unlikely a single approach will be suitable for all units and corporate structures.

The NEM Review is currently doing valuable work developing models for contracting with new capacity using existing widely used financial products and looking to minimise costs by only contracting for the tenor gap period while leaving the market to contract the early years of a project. We encourage DEM to consider the approaches to contracting long-duration firm capacity that the NEM Review is developing, because:

- a) we consider they are likely to achieve superior market outcomes
- b) adopting similar approaches will improve the ability of the schemes to operate in parallel and potentially to be merged at some point
- c) compliance would be simplified as there is no need for revenue calculations or performance obligations

1.3. Market Liquidity and Reliability Obligations

1.3.1. Design of the Obligations

AFMA agrees with the stakeholder feedback cited in your paper that the FERM, as currently designed, is likely to have a negative impact on market liquidity. While as discussed above, we think this is most appropriately addressed through changes to the contracting model to encourage participation in the financial market, we also support market making as a useful mechanism to increase liquidity. Market making will not fundamentally address the physical challenges of the South Australian market where a small load is paired with very high levels of available renewable generation, but we consider that a well-designed Liquidity Obligation could play an important role in boosting market liquidity. Although we do not consider that the proposed approach, which is closely modelled on the Retailer Reliability Obligation (RRO), is the most appropriate way to implement it.

AFMA has been consistently critical of the RRO obligation for retailers to buy prescribed levels of hedge cover as we consider that it increases costs for retailers without delivering the anticipated reliability benefits.¹ We consider that the need for both the FERM and the NEM Review demonstrate that the RRO has not achieved its objective of boosting investment in controllable capacity and we understand that the NEM Review is likely to recommend removing it once their new arrangements are in place. We do not support the proposed Reliability Obligation under the FERM

¹ [https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-\(18\)/R26-23-RRO-Review.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2023/R01-22-AGD-Privacy-Review-Consultation-(18)/R26-23-RRO-Review.pdf?lang=en-AU&ext=.pdf)

both on the basis that it will increase retailer costs without a corresponding reliability benefit, but also because it is not obvious to us why it is required at all under the FERM.

The RRO was designed to incentivise the building of additional capacity by creating demand for hedge cover by requiring retailers to contract to a prescribed level. The FERM, by contrast, attempts to incentivise the construction of capacity more directly by providing incentives to underwrite its construction or continued operation. Under this approach there is no need to mandate hedging by retailers as the direct incentives to generators are intended to drive investment rather than hedging activity by retailers and imposing additional requirements on them will only increase the cost of participating in the South Australian market.

While we do not support the Reliability Obligation, we think there is potentially a role for a well designed Liquidity Obligation. We understand that the NEM Review is exploring a mandatory market making arrangement, possibly modelled on the approach used by the New Zealand Electricity Market which supports both regulated and commercial market making. We encourage DEM to work with the NEM Review Panel to develop a consistent approach to market making. Additionally, we think DEM should consider who any market making obligation should apply to as the current proposal to apply it to all new long-duration firm capacity is likely to be impractical for operators of small new assets.

1.3.2. Interface with the RRO

While AFMA does not consider that the Reliability Obligation is necessary, if DEM decides to implement it, we think it should consider how it will interact with the existing RRO and incorporate the recommendations of the AEMC's review of the RRO.² Particularly:

- Setting the contract position compliance date to 'T' rather than T-1 to reflect actual risk faced by each participant.
- Changes to the firmness rating for eligible contracts to recognise that participants use a range of products, with varying levels of firmness, to manage their exposure to wholesale market risk.

We also think DEM needs to consider how the proposed liquidity and reliability obligations will interface with the existing RRO. We particularly would like to understand how the existing RRO triggers would work alongside the proposed 'always on' reliability obligation.

1.4. Eligible Contracts

The paper proposes that Eligible Contracts should include both ASX listed products and standard OTC contracts that are in accordance with the AFMA Electricity Conventions. AFMA has the following two observations on this approach, the first is that market making obligations typically only apply to listed products and facilitated OTC platforms and we are not aware of another market where they have been extended to bilateral OTC products. The second is that AFMA is currently in the process of revising the AFMA Electricity Conventions to reflect the current dynamic state of electricity market products by recognising that the current suite of electricity derivative products are evolving rapidly and has yet to settle onto a standardised set of products. As a result, we do not think that the AFMA Electricity Conventions are an appropriate basis for determining standardised OTC contracts as going forward they will not list a definitive set of standard contracts.

² <https://www.aemc.gov.au/market-reviews-advice/review-retailer-reliability-obligation>

Given the current rapid evolution of the contract market, we encourage DEM to develop a flexible mechanism for determining eligible contracts based on consultation with market participants and developments in the market.

AFMA Recommendations

- i. South Australian specific arrangements should be designed to work effectively with the NEM regulatory arrangements.
- ii. DEM should explain why continued support for long-duration firm capacity is required after the commencement of anticipated national arrangements and how assets funded under the national arrangements will be treated under FERM.
- iii. The FERM should adopt the approach to contracting new capacity being developed by the NEM Review Panel.
- iv. The Reliability Obligation is unnecessary and should be removed.
- v. If the Reliability Obligation is implemented, it should incorporate the recommendations of the AEMC's Review of the RRO.
- vi. DEM should clarify how the Reliability Obligation will interact with the existing RRO.
- vii. The AFMA Electricity Conventions should not be used as a basis for determining standardised OTC contracts.
- viii. There should be a flexible mechanism for designating eligible contracts in consultation with market participants.
- ix. The Liquidity Obligation should be consistent with the approach taken by the NEM Review.

2. Notice of Intention

In our submission to your Stage 1 consultation, we asked for clarity about how the FERM requirements would apply to assets that did not receive payments under FERM and considered that assets that are not receiving any support to allow them to meet the FERM obligations should have no obligations other than regarding notification of closure dates. The Stage 2 consultation has made it clear that existing units that do not receive FERM payments are expected to make Capacity Commitments under the Notice of Intention framework and will be subject to compliance action if they fail to.

We consider that this is entirely inappropriate as these units will now be subject to additional compliance obligations without the support that other units will receive to allow them to meet them. We anticipate this will have a negative impact on the economics of existing units, increasing the likelihood that they will close, or require FERM payments to keep them open. As stated in our previous submission we consider that assets that are not receiving any support under FERM should have no obligations other than regarding notification of closure dates.

Additionally, we would like some clarity about how the Notice of Intention obligations are expected to apply to new assets built under national arrangements without FERM support.

3. Performance Measurement

AFMA does not support the imposition of LOR performance requirements. As stated in our submission to your Stage 1 consultation, our members have observed that similar requirements under the Capacity Investment Scheme have resulted in two perverse outcomes:

- a) Operational – units withhold capacity during normal market operations to ensure they can meet their contractual obligations during an LOR event.
- b) Investment – proponents’ models must make more conservative estimates about the amount of run time a unit will have as capacity must be reserved to meet their contractual LOR requirements.

The first results in less capacity being available to the market, which will generally lead to higher prices. While the second has resulted in some participants choosing not to participate in other schemes and higher costs for those who do.

In our earlier submission we also asked for guidance about how planned and unplanned outages will be treated under FERM. We noted that prudent operation requires that units have periodic planned outages, and it is inevitable that they will experience forced outages and obviously units that are on outage are unlikely to be able to offer energy during LOR events. The Indicative Term Sheet indicates that outages will be managed by discretionary relief decisions by the Scheme Financial Vehicle. We think this approach will be operationally intensive, is likely to be problematic to implement and prone to disputes.

AFMA considers that a better approach than imposing an LOR availability requirement and conducting ex-post assessments of outages would be for priced FERM contracts to include contractual availability requirements with allowances for planned and unplanned outages, failure to meet the contracted availability requirements would result in contractual penalties. This would be operationally simple and give DEM confidence that the units would be available for large periods of time, including during peak periods, and the operator's flexibility about how they operate their units.

AFMA Recommendations

- x. Assets that do not receive support under FERM should have no obligations other than regarding notification of closure dates
- xi. The FERM should impose contractual availability requirements rather than LOR availability obligations.

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

Head of Energy and Carbon

Consultation Response Template

Question:	Response
Objective and Core Principles	
1. Do you agree with our refined mission, objectives and core principles statements?	No comment
2. Have we sufficiently clarified the interface between the FERM and other market reforms?	<p>No</p> <p>AFMA considers that there is significant overlap between the objectives of FERM and the NEM Review and that it is not clear how the schemes are expected to work together and what the expected role of FERM is after the commencement of the national reforms. (see section 1)</p>
Scheme Operation	
3. Do you have any feedback on the proposed governance framework and structures?	<p>We think there is potentially confusion about the roles of the Financial Vehicle and Scheme Administrator.</p> <p>We understand that the Financial Vehicle is expected to enter into contracts with market participants and that the risk will sit on their balance sheet. But it is unclear to us if the Financial Vehicle or the Scheme Administrator will be responsible for the day-to-day management of FERM contracts.</p> <p>From the contract template it appears that it will be the Financial Vehicle but we question how this will work as in practice the Financial Vehicle is likely to be a special purpose vehicle with a bank account and few staff that</p>

	presumably will depend on the Scheme Administrator's staff to perform its functions.
4. Does our proposed Notice of Intention process clarify and reduce administrative burden on existing generators?	The Notice of Intention process reduces the administrative burden for existing units but as discussed above we consider that the more important issue is the extent to which actual substantive obligations will apply to both existing assets and new assets built without support from FERM. (see section 2)
5. Are the eligibility requirements for existing and new generators clear? Do you have any concerns with these?	No comment.
6. Do you agree with our approach to allow flexibility in the model under which exiting generators could be contracted (where required to meet the FET)? Do you foresee any risks with this approach?	AFMA agrees with the proposed approach to contracting with existing assets. (see section 1.2)
7. Does the proposed tender process for new generators present any challenges or concerns?	The tender process appears broadly appropriate but based on experiences of the Capacity Investment Scheme we think that there would be value in making tenderers record of delivering similar projects in Australia an explicit assessment criteria to minimise the risk of non-delivery of projects.
Scheme Obligations	
8. Do you foresee any risks with our proposed approach to calculating net revenue under the cap and collar model? Do you agree that fuel/energy import costs should be excluded?	No comment
9. Do you support our proposed approach to require both generators and retailers (and other large load customers) to meet a minimum contracting obligation to enhance supply reliability? Would you prefer a FERM-specific approach such as outlined in the draft Minister's guidelines, or to permanently activate the RRO instead (for the retailer obligation). Do you have any feedback on the method for identifying obligated participants,	AFMA does not consider that imposing a Reliability Obligation on retailers is necessary for the function off the FERM, but we do consider that a well-designed Liquidity Obligation may have merit. (see section 1.3)

the types of contracts to include, or the minimum firmness rating of contracts?	AFMA does not support the RRO in general, but we also question if it is an appropriate mechanism for FERM given the potential that it may be repealed as part of the NEM Review.
10. Do our proposed performance requirements and process for assessing an assets performance alleviate any previous concerns you may have had about the scheme's performance requirements?	No, we continue to think that the LOR Requirements are inappropriate and will be cumbersome to implement. (see section 3)
11. Do you have any further concerns with our proposed cost recovery approach?	No comment
Scheme Implementation	
12. Does the proposed implementation timeline for the FERM cause any concerns or are there any further considerations that the Department should be aware of?	We consider that the implementation timeframe is ambitious and question the feasibility of implementing many of the proposed measures significantly before the NEM Review's recommendations.