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Australian Energy Market Commission

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Draft Rule Determination – AEMC ECGS supplier of last resort mechanism

AGL Energy (**AGL**) welcomes the opportunity to provide this submission in response to the Australian Energy Market Commission's (**AEMC's**) draft determination and draft rule for the east coast gas system (**ECGS**) supplier of last resort (**SoLR**) mechanism.

Key points

- **AGL does not consider the Commission has demonstrated that a broad ECGS SoLR is necessary.**
- **The proposed SoLR mechanism is overly broad and risks unintended consequences**
- **The mechanism risks increasing market instability by weakening contracting incentives**
- **The proposed \$800G/J SoLR service price limit does not provide meaningful consumer protection**
- **The timing of the rule change is inappropriate given the heightened uncertainty and multiple overlapping reforms (including the AEMO Governance Review and the Gas Market Review)**

The AEMC has not shown what problem the SoLR mechanism uniquely solves

The strongest case the AEMC has made is for clearer guidance on AEMO's current trading function. That is a reasonable objective. The current arrangements are light on detail, and greater clarity would help market participants and improve regulatory transparency. However AGL does not consider that this demonstrates that a broad SoLR procurement mechanism is required.

That distinction matters because the draft rule is broad. It would allow AEMO to contract for a wide range of services, across the whole ECGS, at any time of year. If AEMO contracts for gas or gas services in a supply constrained market, that does not necessarily create new domestic supply. In many cases, it may simply shift existing supply or services from one party to another. The draft determination does not explain why that is the right answer to the problem it has identified.

If there is a case for intervention, it is easier to see in relation to demand response. AEMO cannot create new gas supply by becoming another buyer. What it may be able to do is reduce demand at the margin. In a genuine shortfall event, where supply cannot be increased in time, reducing consumption may be the only practical way to avoid curtailment. Even then, the case needs to be made clearly.

The draft rule itself also shows that SoLR may not provide a workable response. AEMO may accept no tender, cancel the tender process, and if the mechanism proves insufficient, still rely on its existing direction function. That is important. It shows that SoLR is not the final backstop tool available to AEMO. It also makes it more important for the AEMC to explain why this additional mechanism is needed in the first place. Rule 699J(2) expressly provides that AEMO may use its direction function if it is unable to adequately address the threat through SoLR activation.

The SoLR mechanism may increase, not reduce, market instability

AGL acknowledges the policy intent behind the SoLR mechanism. It is meant to provide a safeguard during serious threats to gas reliability and supply adequacy. However emergency mechanisms have been demonstrated many times to change market behaviour long before they are used.

The experience of the 2022 gas crisis remains relevant. Conditions were difficult and some end users, particularly manufacturers, were heavily exposed. However, the experience also showed the value of prudent contracting. As AGL noted in its earlier submission, participants with firm supply and haulage arrangements were largely protected from undersupply risks and extreme spot prices. Reliable gas supply is not maintained only through intervention powers. It also depends on strong incentives for participants to secure supply and transport in advance and to manage their risk properly.

The draft rule risks weakening those incentives. If market participants expect AEMO to provide a backstop in periods of tight supply, some may contract less conservatively, hedge less, or delay commitments they would otherwise have made. That is the moral hazard concern. It does not depend on the mechanism being used often. The expectation that it may be used can be enough to change behaviour.

Those effects matter beyond the immediate market. Weaker contracting discipline can also weaken the commercial signals that support investment in gas production and gas services. In a market that still relies heavily on contract based decisions, that is a serious risk. A mechanism intended to respond to emergencies may therefore contribute to the conditions that make emergencies more likely, leading to more intervention and higher costs over time.

Competitive tendering changes the mode of intervention, but not the underlying risk

The concern that AEMO's trading function could distort the market, crowd out participants and reduce incentives to respond to threats has been present from the beginning of this process. It was identified in the original rule change request and raised again during consultation, especially in relation to AEMO buying and selling through facilitated markets. The AEMC now appears to treat competitive tendering as the main response to those concerns.

AGL does not consider that this mitigates the identified risk. A tender model may reduce some concerns associated with direct bidding in facilitated markets, but it does not follow that the risk of distortion disappears. Under the draft rule, AEMO would still be able to run procurement processes for gas and gas services across the east coast gas system, including gas supply, storage, pipeline services and administered demand response. In a tight market, that still places AEMO in competition with market participants for scarce supply and services.

The AEMC has not shown why that procurement model avoids crowding out, nor does it cover why AEMO's role as a potential buyer would not affect pricing, service availability, or the willingness of market participants to contract in advance. The critical design detail has also been deferred to AEMO Procedures. The draft rule requires AEMO to make SOLR Procedures covering the tender process, eligibility criteria, assessment criteria and other operational matters. Stakeholders are therefore being asked to accept the proposition that the process avoids distortion before the actual process design has been tested.

The AEMC's own reasoning also suggests that competitive tendering is not a complete safeguard. The draft determination explains that the AEMC did not regard the tender process alone as enough guidance on what AEMO should pay, and for that reason it added a separate SoLR service price limit. Our view is that if the tender model needed an additional constraint to provide discipline, it cannot also be treated as the complete answer to concerns about market distortion.

The \$800/GJ price limit does not protect consumers in any meaningful sense

To provide AEMO with guidance on what it should pay under the mechanism, the AEMC has proposed a SoLR service price limit set by reference to the DWGM VoLL, currently \$800/GJ. The AEMC says this is intended to guide expenditure while still encouraging additional SoLR services beyond what the spot and contract market would otherwise provide.

AGL does not consider this is a meaningful consumer protection.

A formal cap set at \$800/GJ is not a real safeguard against excessive cost. It is simply too high. That concern is sharper because the draft rule removes the current \$35 million trading fund and does not replace it with any aggregate financial cap on total SoLR expenditure. In practical terms, the only explicit financial safeguard is a very high per GJ ceiling.

There is also a deeper tension in the AEMC's reasoning. The draft determination says the price limit is intended both to constrain AEMO's costs and to induce additional SoLR services beyond what the market would otherwise provide. Those are not naturally aligned objectives. If the mechanism needs to procure services beyond ordinary market outcomes, then the AEMC is accepting that AEMO may need to pay above normal commercial levels to secure a response. That is not simply a matter of guidance. It is a policy choice to support intervention at prices above prevailing market outcomes.

If the mechanism is genuinely intended to operate only as a last resort, market participants should have strong incentives to take efficient action before AEMO intervention is required. The draft rule does not clearly explain why this would not occur. To the extent that the justification is that AEMO may need the ability to procure responses at prices higher than those the market would otherwise deliver, that rationale should be stated explicitly and justified transparently. As currently framed, the draft rule attempts to position the price limit simultaneously as a cost containment safeguard and as a tool to elicit responses that the market would not otherwise provide, without clearly reconciling this internal tension.

Timing of this and other rule changes

Recent developments in the Middle East have materially increased uncertainty in global energy markets, particularly for LNG supply, pricing volatility and security of gas availability. While Australia is not directly exposed to supply disruptions in the same way as import-reliant jurisdictions, domestic gas prices, contracting conditions and infrastructure utilisation remain highly sensitive to global LNG dynamics. In this context, undertaking structural rule changes that assume stable or predictable long-term gas demand and supply conditions risks locking in regulatory settings that may prove maladaptive under heightened volatility.

Elevated geopolitical risk reinforces the need for regulatory optionality and caution, particularly where reforms could constrain investment, alter cost recovery, or affect asset utilisation during periods when gas infrastructure may play an enhanced role in maintaining energy security and electricity system reliability. Proceeding with this rule change at a time of such uncertainty risks undermining resilience precisely when flexibility and investment confidence are most needed.

In addition, the Commission should carefully consider the interaction between this proposed rule change and ongoing or foreshadowed reforms to AEMO's governance, functions and accountability arrangements. Any expansion or clarification of AEMO's role through delegated powers, implementation discretion or interpretive authority should not precede the finalisation of governance reforms that determine how those powers are exercised, overseen and constrained.

Introducing new obligations or frameworks that rely on AEMO decision-making, while its governance settings remain under review, risks creating ambiguity, duplicating reform effort, or embedding misaligned responsibilities that may need to be revisited once governance changes are settled. A prudent approach

would be to pause or sequence any delegation of new functions to AEMO until governance reforms are finalised, ensuring institutional clarity, regulatory coherence and confidence for market participants.

Finally, the Commission should consider the interaction between this rule change and the ongoing Gas Market Review and any associated domestic gas reservation policy reforms. These processes have the potential to materially affect gas availability, pricing dynamics, infrastructure utilisation and investment signals across the supply chain. Implementing structural network and market rule changes in advance of clarity on gas reservation settings risks creating misaligned incentives or unintended consequences, particularly where upstream supply, contracting behaviour and domestic prioritisation outcomes are still under active consideration.

A coordinated and sequenced approach, in which the outcomes of the Gas Market Review and domestic gas reservation policy are first settled, would better support regulatory coherence, reduce policy risk for market participants, and ensure that subsequent rule changes are appropriately calibrated to the future role of gas in the energy system.

If you have any questions about this submission, please contact Warren Vosper on wvosper@agl.com.au.

Yours sincerely,

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