AEMC
Australian Energy Market Commission

INFORMATION

Improving contingency FCAS arrangements

The Commission has made a final rule to formalise arrangements to co-optimise the size of the largest credible contingency

The Commission has decided to make a more preferable final rule to formalise the Australian Energy Market Operator's (AEMO) obligations relating to its current practice of co-optimising the volume of contingency frequency control ancillary services (FCAS) procured with the size of the largest credible contingency in dispatch. The final rule, which is a more preferable rule, seeks to:

- formalise the requirement for AEMO to use reasonable endeavours to co-optimise the size of the largest credible contingency, in central dispatch
- require AEMO to set out how it will perform co-optimisation of the largest credible contingency in the constraint formulation guidelines
- requires AEMO to report on the instances in which contingency size co-optimisation constraints are applied and, where applicable, AEMO's assessment of the extent of co-optimisation.

In considering stakeholder feedback on the draft determination and draft rule, the Commission makes a minor revision to the draft rule clause 4.8.16(b) to focus AEMO's quarterly reporting requirements on the extent of co-optimisation usage over time, rather than the impact of co-optimisation. The Commission considers that quantifying the impact of individual instances of co-optimisation would require significant assumptions to establish a counterfactual, and would be resource-intensive without providing benefits commensurate with the cost. The final rule does not make any other substantive changes to the draft rule.

The final rule is in response to two related issues raised by Grids Energy Pty Ltd (proponent). We have assessed these rule change requests together due to their shared subject matter and common objective – to improve the National Electricity Market's (NEM) contingency FCAS frameworks.[1]

The proposals are summarised below:

- **ERC0359 – Optimising contingency size in dispatch:** proposes that co-optimising the size of the largest credible contingency by treating it as a variable as opposed to an input in the NEM dispatch engine (NEMDE), would help reduce the total costs of energy and FCAS procured. For more information, see: https://www.aemc.gov.au/rule-changes/optimising-contingency-size-dispatch
- **ERC0360 – Allocating contingency FCAS costs:** proposes a 'runway' cost allocation approach, which the proponent considers improves on the cost reflectivity of the current cost recovery arrangements. This method would concentrate costs on the largest generators or loads, whose potential loss defines the contingency size and drives the contingency FCAS requirement. For more information, see: https://www.aemc.gov.au/rule-changes/allocating-contingency-fcas-costs

The Commission does not propose any change to the existing cost recovery arrangements.

The benefits of implementing mandatory co-optimisation are modest

AEMO procures contingency FCAS to maintain a secure power system in the event of a credible contingency, such as the sudden loss of a generating unit or transmission line. The volume of contingency FCAS procured in each dispatch interval is primarily

[1] The rule change requests were consolidated under the NEL on 4 June 2026.

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determined by the size of the largest credible contingency. NEMDE determines dispatch outcomes by co-optimising energy and FCAS bids to meet demand at least cost while maintaining system security. However, under current arrangements, the size of the largest credible contingency is typically treated as an input to the dispatch process rather than a variable that can be adjusted to improve overall efficiency (i.e. co-optimised). AEMO currently co-optimises the size of the largest credible contingency in dispatch, under some circumstances set out in AEMO's constraint formulation guidelines. AEMO undertakes this practice in accordance with its requirement to maximise the value of spot market trade.[2]

The issue raised by the proponent relates to whether dispatch efficiency could be improved by requiring AEMO to co-optimise the size of the largest credible contingency in all circumstances. In relation to this, the Commission considers that more frequent co-optimisation could enhance FCAS price efficiency within the NEM. However, in considering stakeholder feedback, the Commission considers:

- the benefit from expanding AEMO's current approach to co-optimising the largest credible contingency is likely to be small and concentrated in limited intervals, with minimal benefits to be realised beyond what is already occurring through existing practices
- there are material implementation costs and risk considerations associated with the development of new constraints, particularly in the context of other reforms currently underway
- there is uncertainty as to whether market efficiency could be improved over time by expanding the use of co-optimisation constraints.

While the Commission recognises that AEMO currently co-optimises the size of the largest credible contingency, the final rule formalises the process under which AEMO undertakes co-optimisation and includes measures to improve its transparency. The Commission considers that these measures would support continuous improvements to the use of co-optimisation constraints as the power system continues to transition.

The final rule is designed to enable continuous improvement of co-optimisation practices over time

The Commission considers that greater clarity and transparency would improve stakeholder visibility of AEMO's practices and allow for a more thorough consultation process on the development of the constraint formulation guidelines. The final rule requirement for AEMO to include information on co-optimisation in its existing weekly and quarterly frequency performance reporting, would provide sufficiently granular visibility on co-optimisation practices. The Commission considers that this would promote a more considered assessment of the need to expand the application of contingency size co-optimisation over time, while avoiding disproportionate implementation costs and risks.

To give effect to the above outcome, the rule also introduces a transitional arrangement requiring AEMO to undertake a review of the co-optimisation arrangements under the constraint formulation guidelines, and complete this review process by 1 October 2028, taking into account the publication of weekly and quarterly reports under the draft rule. See below for the proposed implementation schedule.

The Commission proposes a staged implementation approach for the final rule

The final rule will be implemented on a staged basis to align with AEMO's existing reform priorities, as follows:

- provisions clarifying the requirement for AEMO to use reasonable endeavours to undertake co-optimisation will commence on 4 September 2026
- new transparency and reporting obligations will commence on 1 October 2027, allowing sufficient time for system build, automation and consultation.
- the transitional arrangements will require AEMO to complete a review of the constraint formulation guidelines by 1 October 2028.

2 NER, clause 3.4.1(a).

The Commission does not propose to make changes to cost recovery arrangements at this stage

The Commission has decided not to pursue changes to contingency FCAS cost recovery arrangements at this time. This includes both the runway cost recovery approach proposed by the proponent and alternative cost recovery methodologies, including hybrid runway models, frequency performance payments and deviation pricing. The Commission found these alternatives to be unsuitable, as they do not materially improve upon current arrangements or justify the associated costs and risks.

While a more cost-reflective cost recovery arrangement could improve incentives for participants to consider the capacity size of their investments on the volume of contingency FCAS required, the Commission considers that, in practice, such reforms would be complex to implement, and are unlikely to produce material benefits for consumers.

The Commission also noted that, under runway cost recovery, all participants face a financial incentive to reduce output in order to lower their cost exposure and avoid moving up the runway. However, a reduction in output from participants who are not part of the largest credible contingency would not affect the volume of contingency FCAS required. This analysis, as well as stakeholder feedback to date, indicates that implementing runway pricing, particularly in the absence of mandatory co-optimisation, could create incentives that tend to increase system costs, particularly during periods of scarcity.

The Commission considers that the final rule provides a pathway for future consideration of cost-recovery reform, by improving transparency and the evidence base on how dispatch outcomes, FCAS procurement and system costs interact over time.

All stakeholders who commented on cost recovery arrangements supported the Commission's draft determination to not make any changes to these arrangements.

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