



**Government
of South Australia**

Department for
Energy and Mining

Firm Energy Reliability Mechanism

Market Liquidity Obligation

Consultation Paper - Response
Template





Submitted by:

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Please indicate any parts of your submission to be treated as confidential	<p><u>Additional comments:</u></p> <p>This response contains the views of Stanwell only and should not be construed as indicative or representative of the views of the Queensland Government.</p> <p>The Queensland Government has not agreed to the Recommendations made by the NEM Review Panel noting in particular the Electricity Entry Services Mechanism (ESEM) and the Market Making Obligation (MMO).</p>

Question:

1. Do the proposed approaches of allowing obligated participants to participate at the group level (for REE's that are part of a larger corporate group) or to nominate a trading entity (e.g. for obligated participants that may not have trading resources/capability, or for instances when trading resources are unavailable) provide sufficient operational and commercial flexibility? Are there any risks with this approach?

Response:

Risk management and allocation

Risk appetite should remain the remit of the obligated party's Board and not be imposed through legislation. Participants should not be compelled to assume risk positions or force exposure beyond their risk position, as will occur under the MMO proposal.



There must be an ability for an otherwise-obligated entity to stop market making if its position has reached its self-determined risk limits.

Consideration of participants' existing obligations

The MMO should not compel trading when it would cause the market maker to breach other existing obligations. Any MMO must clearly operate beneath existing competition and financial services laws, not alongside or in conflict with them. Participants should not be placed in a position where compliance with an MMO would force a breach of other regulatory obligations.

Group level participation

Stanwell supports the obligated entity being able to nominate an entity to discharge its obligation, subject to appropriate anti-avoidance arrangements being in place.

As the draft design is one-sided (obligation based on size of generation) these anti-avoidance requirements appear minimal – such as the nominated entity having an ASFL and valid exchange account.

If the MMO were to become two-sided there may be additional anti-avoidance requirements such that related entities incurring an obligation on each side of the market cannot unreasonably avoid participation by netting their positions.

Similarly, if an obligated party can nominate a non-group entity, that entity should be required to meet the sum of any obligations it assumes. That is, if a trading house (or ESEM administrator) assumed obligations from two entities, its obligation must equal the two original obligations, not one.

The draft design does not appear to account for the proposed ESEM design. Under that mechanism the investor initially sells long-term financial products to the ESEM administrator who warehouses them until they are required by the liquid market. Under this approach the obligated entity should be the ESEM warehouse as the investor/generator has already sold its position and should not be required to market-make and risk selling more volume than it has.

Participant thresholds

Expecting a limited number of large participants to carry ongoing market making is unlikely to deliver resilient or competitive liquidity outcomes. Liquidity is more likely to deepen if obligations are spread across a broader and more diverse group of market participants. This may better accommodate the number of entities anticipated to enter the FERM scheme (i.e. 400 MW by November 2028, 200 MW by November 2029, and 100 MW by November 2031).



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2. Do you have any concerns with the proposal to initially limit SA MMO products to ASX-style cap contracts?

Response:

We believe this is linked to Question 6; the minimum firmness rating.

If there is a minimum firmness rating (as exists in the current MLO) then other products would be allowed, including higher strike caps than are currently listed on ASX. Where no explicit firmness rating is included, we believe the practical intent should be maintained.

For example, a \$1000 strike cap would mitigate over 95 per cent of the risk inherent in individual price spikes (currently capped at \$20,300) - well above the 0.8 firmness factor in the current MLO. There appears no basis to exclude caps above \$300/MWh (such as the \$600/MWh caps currently listed on TOD Markets).

The use of caps seems appropriate in the context of SA FERM which aims to incentivise long duration firm resources such as energy storage. However, as the SA MMO is being (in part) progressed as a proof of concept for a NEM-wide MMO, we would be concerned if products were limited to caps only beyond this initial trial.

The MMO should not require one side of the market to hedge to a minimum volume. Market makers should come from both sides of the market. Where both commercial and obligated market makers exist, obligated market makers in that region should not have to contribute to the market making levy as they already provide more service than other participants.

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3. Would adopting a different (relaxed) bid/offer spread (Option one), or lowering the daily volume requirement (Option two) in the prompt quarter be an effective risk management tool for obligated participants? Which option do you prefer?

Response:

No market making in the prompt quarter.

Stanwell has strong reservations as to whether the MMO should apply in the prompt quarter. The prompt quarter is generally more volatile than the forward quarters, with prices moving more sharply. Mandatory two-way pricing may force participants into undesirable positions and carry exposure at a point when prudent risk management (i.e. hedging should already be finalised).

Mandatory market making close to delivery could lead to repeated 'one-way' trading in a fast moving market, particularly if spreads are too narrow, ultimately distorting liquidity rather than supporting it. Obligated participants would in practice be required to withhold hedging volumes from earlier periods in order to be able to market make in the prompt quarter.

If the MMO is applied for the prompt quarter, significantly wider spreads (than in the forward quarters) would be needed – although this is not our preferred option for the reasons noted above.

Trading exemptions

Having a relief mechanism is appropriate in principle. The proposal of five days relief in a rolling twenty day period is likely to be sufficient in most circumstances but may create regulatory conflict in other circumstances. Five days should be considered an indicative benchmark, rather than a hard cap.

If applied as a hard cap, once the relief period is exhausted, participants would still be technically required to market make. A fixed numerical cap on relief days could, in practice, force participants to choose between breaching the MMO or another law.

Trading day based MMO obligations must be flexible, with clear carveouts, to ensure participants are not penalised for lawful and necessary decisions to suspend trading. A rigid trading day framework could invite ex-post regulatory scrutiny or second-guessing of those decisions if carveouts are not explicit.

Relaxing the bid/offer spread

Wider spreads (rather than narrower spreads with lower volumes) work to reduce participant transaction costs (higher transactions costs may limit a participant's ability to hedge). The ASX voluntary market making arrangements have been increased from 5% to 7% spread and have proven to be more workable at this level.

If products covering less hours are to be included (e.g. peak contracts rather than flat) the spreads should be wider reflecting the concentration of risk.

Session volume caps are essential to ensure MMO entities are not forced to be caught in a market event. Cumulative volume caps are likely to be necessary to ensure participants are not forced to oversell or overbuy rational risk positions. This will help to ensure that a natural seller, (e.g. a generator), is not forced to lift a non-competitive offer (or give a bid) only to be able to offer MMO volumes.

While reducing volumes may limit exposure, it also reduces the usefulness of the obligation by preventing counterparties from executing meaningful trades which may materially undermine liquidity.

Narrower spreads are problematic and risk forcing participants into large one-sided positions over consecutive days, particularly during periods of sustained market momentum. Whereas wider spreads, even in fast-moving markets, support visible liquidity and are less likely to force one-sided exposure.



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4. What are the risks or complexities with adopting either of the options proposed in Question 3 above?

Response:

The allocation of obligations is a major issue. Stanwell cautions against an approach that implicitly targets generators, noting that the MMO is not a minimum hedging obligation and should involve participants on both sides of the market.

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5. What is your preferred MMO trading window, 11:00 – 11:30 am or 3:30 – 4:00 pm (AEST) and why?

Response:

We propose a defined window with an internal buffer (e.g. 25 minutes within a 30-minute window) ideally later in the day, (say between 3:00 – 3:30 pm) which may reduce risk and preserve liquidity. Market making very close to market close may be problematic, with recent moves to limit trading and price changes close to close in order to reduce (actual or alleged) gaming.

For example, currently some clearers limit changes during the last 120 seconds of the day which may prevent a market maker responding to new information during that window. Market makers should be free to move with the market for the duration of the liquidity window.

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6. Are there any risks with not stipulating a minimum firmness rating for SA MMO products?

Response:

As per our response to Question 2.

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7. Do you have a view regarding the requirement for, and a potential approach to, including a mechanism to ensure bid/offer spreads are available for a minimum time each trade period (unless traded)?

Response:

Existing voluntary market-making schemes allow the exchange to confirm when orders are placed and removed, confirming that they meet the requirements of the scheme. Such capability appears to be a required component of approving an exchange, so we do not believe any extra capability is required.



Bid-ask spreads should be flexible to adapt as market conditions, contract types, and underlying technologies evolve. As the MMO appears to be “a stronger version” of the MLO, volumes and spreads should initially be based on MLO arrangements.

Cumulative price response

Cumulative response created in the daily MMO period when expressed as a percentage of daily capacity over a full trading year will compound over time. While a 2% or 5% daily obligation may appear modest on any given trading day, applying it across say 750 trading days materially changes the risk profile, particularly in volatile markets. Repeated execution at that level could amount to effectively turning over the participant’s entire hedge book.

This increases the risk of one-sided exposure where the obligation could systematically add to an already exposed position, rather than facilitating a balance to liquidity.

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8. Are there any additional capabilities of competencies to those outlined in the consultation paper that the Scheme Regulator could consider incorporating in a platform approval process?

Response:

N/A.

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9. Do you agree with our approach to managing the interplay of the RRO/MLO and SA MMO via the SA MMO exemption process?

Response:

The MMO should not overlap the MLO. If an MLO exists it should either be replaced by the MMO, or the MMO should be delayed until the MLO is complete. Our preference is to have the RRO rescinded as early as possible. This aligns with the recommendation in the NEM Review to repeal the RRO.

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10. Does the proposed implementation timeframe for the SA MMO cause any concerns, or are there any further timing considerations that the Department should be aware of?

Response:

We have always opposed the development of a mandatory MMO, and the expeditious timeframe proposed for its implementation – our position has not changed. However, given the development of the NEM-wide MMO is now underway, Stanwell would like to see the SA MMO as closely aligned as possible to the NEM MMO to avoid conflicts. Additionally, as the SA FERM MMO is anticipated to be the ‘test case’ for wider application across the NEM (with the NEM MMO framework anticipated 2026 and implementation scheduled for 2027),



it seems advantageous to more thoroughly develop the proof of concept (i.e. extend the development timeframe), to minimise the risk of unforeseeable and unintended consequences.

11. What design elements could be included in the SA MMO framework implemented under the FERM Regulations to facilitate a smooth transition to a NEM-wide MMO?

Response:

The role of financial market participants

Financial participants are unlikely to act as voluntary market makers without explicit compensation. Market making is a commercial activity that exposes participants to real risk. Financial players are unlikely to undertake a risk if the expected return outweighs the risk of adverse exposure. For example, in the New Zealand Electricity Market (NZEM) financial market makers are paid to provide liquidity.

The current proposal places the burden on the physical market only and assumes that the physical markets will absorb the cost and risk of compliance as part of their broader market role – noting this is not a function of physical asset ownership.

Obligated physical participants should be permitted to pay a third party to assume the market making obligation on their behalf. This seems to be a reasonable way to involve financial market makers without forcing them into unpaid obligations. Under this approach:

- specialist financial firms could take on the obligation if they believe they can manage the risk efficiently, and
- physical participants could avoid being forced to market make where it is not commercially efficient for them to do so.

Financial players cannot realistically be excluded from trading as MMO activity would occur on visible exchange platforms. Even if not obligated, financial participants will trade against MMO quotes if opportunities arise. This reinforces the view that:

- it is inconsistent to prevent financial participation while relying on market liquidity, and
- a framework that allows financial firms to be paid to provide market making services is more coherent.

Future ESEM proofing

- As noted in our response to Question 1; the current design does not appear to account for the proposed ESEM model where the registered generator does not hold the financial market position.
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- The proposed design – limited to caps – also contradicts elements of the proposed ESEM model where some entrants would sell swaps or other products to the ESEM administrator. Ensuring the SA MMO design does not preclude these products is important.
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