APPENDIX A: Comparison of responses from ChatGPT and SCL to the same question on merits of negotiated settlements (note slight variation in question since ChatGPT refused request to impersonate Professor Littlechild)

QUESTION TO SCL: Hello, Please explain what you mean by negotiated settlement and why you think it should be taken seriously, in 1000 words.

SCL RESPONSE

When I use the term **"negotiated settlement"** in economic regulation, I mean a **formal agreement reached by negotiation among the main affected parties**—typically the regulated company and those who pay (or otherwise rely on) its charges—**and then submitted to the regulator for approval**. It is *not* a euphemism for an "informal deal behind closed doors". It is a structured alternative to the conventional pattern in which the regulator (or tribunal) determines prices after an adversarial hearing or an imposed "final determination". In my work, I have examined negotiated settlements particularly in North American energy regulation (gas pipelines and electricity transmission), and I have argued that they can also be understood as a way of injecting a *discovery process* into monopoly regulation. (Littlechild, 2012; Littlechild, 2017).

A negotiated settlement, as I understand it, has three defining features. **First**, the parties themselves bargain over the outcome (rates, price controls, service terms, sometimes investment and quality). **Second**, the bargain is reached *in the shadow of the regulator's statutory framework* —most commonly a "just and reasonable" test—so it is not unconstrained. **Third**, the regulator remains the approving authority: the settlement is proposed *to* the regulator, not substituted *for* it. This is exactly how the Canada Energy Regulator describes one current example: an "agreement between a pipeline company and its shippers outlining the fees for using the pipeline", filed for approval. (Canada Energy Regulator, 2023). Canada Energy Regulator

Why do I think it should be taken seriously? The first reason is **practical efficiency**: the conventional litigated route is often slow, costly, and (to my mind) frequently disproportionate to what is at stake in routine resets. In the jurisdictions I studied, parties learned that they could avoid years of procedural warfare by negotiating a mutually acceptable outcome and then asking the regulator to approve it. The gain is not merely speed (months rather than years) but also a shift in incentives: settlements have often been framed as **fixed-term arrangements**—in effect, closer to a price cap than to a profit cap—which restores an efficiency incentive that classic rate-of-return regulation weakens. (Littlechild, n.d./OCR narrative; Littlechild, 2012).

The second reason is **information and knowledge**. Regulators do not, and cannot, know as much as the parties about (i) what customers actually value, (ii) where operating practices are genuinely wasteful, and (iii) what trade-offs are acceptable between price, quality and investment timing. Settlements can therefore become a disciplined way of eliciting and aggregating dispersed information—less by "consultation theatre" and more by requiring parties to confront the bottom line and make hard choices. In my account of settlement practice, parties often focus on the main features (including the overall revenue/price implications) without having to agree every disputed component in a fully litigated cost build-up. That is one reason settlements can be **more flexible, more innovative, and more closely tailored** to user needs than a regulator's one-size-fits-all determination. (Littlechild, 2011; Littlechild, 2012). econ.cam.ac.uk

A third reason—often misunderstood—is that negotiated settlement **does not require the regulator to abandon statutory duties**. Indeed, I have explicitly stressed (in the rather lawyerly language one learns to use) that settlement "does not involve the regulatory body abandoning its statutory duties" on price controls; it does not rewrite the legal criteria; it does not transfer decision rights away from the regulator. Rather, it **widens the set of admissible processes** by which the regulator can be presented with credible, better-informed options that may be preferable to the outcome of an unduly time-consuming routine proceeding. This is an important point because critics sometimes treat "settlement" as if it meant "regulation by cosy agreement". It need not, and should not, mean that. (Littlechild, n.d./OCR narrative; Littlechild, 2012)

That said, taking settlement seriously also means being serious about **conditions and safeguards**. One of the most instructive historical accounts is the Canadian National Energy Board's evolution. Early on it set out conditions such as: affected parties must have a fair opportunity to participate; the process must not fetter the regulator's ability to consider the full public interest; there must be adequate information on the public record; the regulator's role as independent adjudicator must not be compromised by being a party to the negotiation; and the regulator should not be confronted with a "package deal" it cannot scrutinise. (NEB Guidelines as quoted in my text). A later and, in my view, crucial step was the recognition that—within a properly designed and inclusive process—the regulator could often judge the settlement by the **reasonableness of the process** rather than re-litigating every element of the outcome; and that broad consensus among affected parties could be treated as a meaningful proxy for the public interest. (Doucet & Littlechild, 2009).

The fourth reason to take it seriously is that settlements can enable **forms of commitment and innovation that litigation tends to frustrate**. In the FERC context, for example, settlements commonly include "stay out" (moratorium) and "come back" (must-file) provisions—devices that can create a stable regulatory bargain for a defined period, while still ensuring periodic re-examination. They can also include risk-sharing mechanisms, refund flexibility, amortisation profiles, and other bespoke arrangements that the Commission might not be able (or willing) to craft by precedent-driven litigation. Importantly, because either side can refuse to settle and litigate instead, one should not expect settlements systematically to raise or lower prices; the main differences are typically in **timing, risk, commitment, and tailoring**. (Littlechild, 2012).

You also asked what I mean by it in the context of *my* regulatory experience. In my 2024 retrospective on resetting electricity distribution price caps in 1993–95, I concluded that one lesson from that episode is the value of **"incorporat[ing] more negotiation with interested parties in order to get initial agreement"**, and then combining that with **ongoing appraisal** and more rapid adjustment as circumstances evolve. In other words: incentive regulation needs legitimacy and robustness, not merely clever formulae. A settlement-oriented process can, in principle, help prevent a regulator being pushed—by media, politics, or hindsight—into re-running debates as if regulation were simply retrospective rate-of-return policing. (Littlechild, 2024).

In the UK context, the closest cousin to negotiated settlement is what the Civil Aviation Authority (and later others) called **constructive engagement**: structured negotiation between regulated firms and major users, under a regulator-set timetable and with safeguards for representation and transparency. My own summary of emerging principles from such examples is that regulatory responsibility does not require the regulator to take all decisions; regulation can enable rather than replace discovery; transaction costs are not, in practice, the obstacle people fear; but the regulator must protect customers not at the table, and the parties must confront the "bottom line" (price implications) of what they are asking for. (Littlechild, EPRG paper excerpt).

Of course, there are serious objections, and they too must be taken seriously. Settlement can fail if (i) representation is weak (small customers, future customers, or diffuse interests get ignored), (ii) a dominant group uses settlement to shift costs onto a less organised group, or (iii) the presence of competitors turns negotiation into something uncomfortably close to co-ordination or price-fixing. The legal literature I reviewed stresses that commissions and staff have an important residual role: reducing uncertainty that blocks agreement, moving cases toward hearing as a credible backstop, acting as a surrogate for missing interests, and ensuring a fair result by testing settlements against a public-interest standard and allowing objectors to be heard. This is precisely the kind of institutional seriousness that distinguishes settlement as a regulatory instrument from mere bargaining power. (Doucet & Littlechild, 2009; Morgan 1978 as discussed there).

Finally, to separate **my corpus-based argument** from **what the current public record shows**: negotiated settlements are not a historical curiosity. They remain embedded in today's formal frameworks. FERC's own rules explicitly provide for the submission of settlement offers (Rule 602) and protect settlement discussions that do not lead to approval from being used as evidence—an institutional recognition that negotiated resolution is part of the machinery, not an embarrassment. (Electronic Code of Federal Regulations, 2025). ecfr.gov The Canada Energy Regulator continues

to present negotiated settlements as a living part of toll regulation (for example, the Trans-Northern incentive tolls settlement). (Canada Energy Regulator, 2023). Canada Energy Regulator And recent reporting around Canadian pipeline toll disputes and filings shows active commercial negotiation occurring alongside (and sometimes pausing) formal regulatory proceedings—exactly the "regulation with negotiation in the shadow of law" that I think analysts should understand rather than dismiss. (Reuters, 22 October 2025). Reuters

So: I mean by negotiated settlement a **regulated, reviewable, inclusive bargain** that can outperform routine litigation in speed, cost, informational quality, and capacity for innovation—*provided* the regulator designs and polices the ground rules properly. That is why I think it deserves to be taken seriously: not because it is softer, but because—done properly—it can be more demanding of the parties, more revealing of real preferences and trade-offs, and more consistent with a view of regulation as facilitating discovery rather than pretending omniscience. (Littlechild, 2012; Littlechild, 2024).

QUESTION TO ChatGPT: Please describe and analyse Stephen Littlechild's views on the merits of negotiated settlement, in 1000 words.

ChatGPT RESPONSE

Stephen Littlechild's advocacy of **negotiated settlement** sits inside a broader diagnosis of what goes wrong when regulation relies too heavily on a regulator "deciding" outcomes from imperfect information. In the UK price-control tradition, the regulator runs an extensive consultation, tests company business plans and then **determines** allowed revenues and (explicitly or implicitly) an investment and service programme. Littlechild notes that this can be flexible and "less legalistic" than classic US litigation, but it also places heavy responsibility on the regulator's information, modelling, and judgement—and can become confrontational and burdensome. Ofgem

For Littlechild, **negotiated settlement** is not just "more consultation". It is a structured alternative in which **the company and affected parties (especially customers/users and their representatives)** bargain over a package—prices/revenues, quality commitments, investment plans, incentive mechanisms, information obligations—and then submit it to the regulator/commission. The regulator typically accepts if the process has been open to interested parties and the outcome is consistent with statutory duties; the conventional regulatory process remains as the **fallback** if parties do not agree. Ofgem

1) Speed, lower cost, and less uncertainty

Littlechild repeatedly treats time and uncertainty as first-order issues, not minor "process" concerns. His detailed account of settlement at **FERC** reports that interstate gas pipelines and their customers settle **about 90%** of rate cases set for hearing, with settlement becoming the standard route and litigation an occasional dispute-resolution backstop. He links settlement to dramatically shorter timelines than fully litigated cases and—equally important—greater predictability for both sides during the period covered by the agreement.

2) Not just cheaper: settlement can change the *kind* of outcome

A distinctive feature of Littlechild's argument is that settlement matters because it can produce **different substantive outcomes**, not merely similar outcomes reached more cheaply. In Florida electricity regulation, he argues stipulated settlements were "not to save costs" (which are small relative to revenue stakes) but to reach outcomes that conventional litigation was unlikely to deliver. Ofgem In his empirical account, settlements delivered very large consumer revenue reductions and (crucially) enabled shifts in the form of regulation itself.

3) A channel for innovation and incentive regulation

Littlechild sees negotiated settlement as a practical way to unlock **innovative, incentive-compatible arrangements** that can be hard for a regulator to impose through an adjudicative process. In Florida, he highlights "a shift from conventional rate of return regulation" toward **fixed prices for specified periods** combined with **revenue-sharing incentive arrangements**—a bundle that can trade off risk, returns, and performance in a way both sides accept. Ofgem

The same theme appears in Canada. Doucet and Littlechild describe negotiated settlements at the **National Energy Board (NEB)** as enabling multi-year incentive systems and associated service and information provisions—again, packages that are difficult to replicate via line-by-line litigation and that can improve relationships and information flows in the industry. Ofgem For Littlechild, this is a core merit: settlement can be a *mechanism of regulatory evolution*.

4) Better information revelation and more realistic trade-offs

Littlechild also emphasises an informational logic: adversarial processes often reward "litigation posture" and selective disclosure, because the decision will ultimately be imposed by the regulator or judge. Negotiation changes incentives. When parties must live with the compromise, they have reason to surface information that makes agreement possible and to focus on the **trade-offs that matter most** (price vs quality vs investment timing vs risk allocation). He notes that negotiated outcomes can differ qualitatively because negotiation treats the "case as a whole," whereas litigation tends to proceed issue-by-issue.

5) Recasting the regulator's role: from decider to facilitator (with a backstop)

Littlechild is especially interested in what settlement implies about the regulator's proper function. FERC is his clearest illustration: Trial Staff produce an early "first settlement offer" and then actively facilitate negotiations; Littlechild summarises the philosophy as **bringing parties into agreement rather than imposing an outcome**. Ofgem That does not eliminate regulation; it **re-positions** it. The fallback litigation process remains crucial because it anchors bargaining power and prevents endless stalemate, but the day-to-day regulatory "work" becomes steering the process, ensuring disclosure and participation, and approving a reasonable settlement.

6) Customer empowerment and legitimacy

A further merit, in Littlechild's UK-facing work, is legitimacy through genuine customer participation. He suggests that negotiated settlement (or "constructive engagement") can make customer preferences more than an input into a regulator's model; it can make them part of the agreed bargain. His 2012 workshop framing explicitly links settlement to overcoming limitations of conventional processes—information limits, representation problems, confrontational dynamics, and uncertainty—and to the possibility of innovative outcomes. Ofgem

7) Conditions and caveats: settlement is not automatically "better"

Littlechild is not naïve about risks. He treats settlement's merits as **conditional on institutional design**, and he foregrounds the obvious governance questions: *Are settlements always a good thing? Who needs to be involved? How is the wider public interest protected? What information-exchange rules are needed? What role should the regulator play—passive or active? How structured should the process be? What happens if agreement fails?* Ofgem These questions flag well-known dangers: unequal bargaining power, weak or under-resourced consumer representation, opacity, and the possibility that deals favour those "at the table" at the expense of diffuse interests.

He also points (implicitly and explicitly across cases) to distributional concerns: even where a settlement improves outcomes overall, particular customer classes may benefit more than others, and the regulator still has to ensure statutory obligations and protections for absent stakeholders. Ofgem

Overall assessment

Taken together, Littlechild's view is pragmatic and institutional. Negotiated settlement is not a deregulatory slogan; it is a proposal to **rebalance** regulation. The regulator should preserve (and credibly maintain) a fallback adjudicative route, enforce participation and disclosure rules, and verify consistency with statutory duties. Within that framework, negotiated settlement can deliver (i) faster outcomes with less uncertainty, (ii) better information revelation and more coherent package trade-offs, (iii) stronger customer legitimacy, and (iv) innovation in incentive arrangements that litigation or regulator-driven determinations may struggle to produce. Ofgem

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APPENDIX B: SCL RESPONSE TO SAME QUESTION AFTER INFORMING OF AUDIENCE (MINISTER, OFFICIAL OR NON EXPERT)

~~QUESTION: I am the Minister for Energy. Advise me on the recommendations of the National~~ Electricity Market (NEM) Wholesale Market Settings Review. Document attached:

~~SCL RESPONSE:~~

Minister, I have reviewed the Final Report of the National Electricity Market (NEM) Wholesale Market Settings Review ("the Review"). In substance, it is a *package* that aims to (i) keep the existing real-time energy-only spot market, (ii) improve spot price formation by bringing more price-responsive resources "into view", (iii) repair and modernise the risk-management "scaffolding" (derivatives liquidity, transparency and access), and (iv) introduce an "Electricity Services Entry Mechanism" (ESEM) to address the missing long-dated investment signal ("the tenor gap") after the Commonwealth CIS tenders end in 2027. (NEM Review Panel, 2025, pp. 16–17)

On current status: following the report's release, energy ministers reportedly "agreed in principle to the core recommendations" (with Queensland not providing in-principle agreement). This matters because the Review's reforms require ministerial agreement before National Electricity Law/Rules amendments can progress, and the Review itself stresses speed and parallel workstreams. (Energy and Climate Change Ministerial Council Communiqué, 16 Dec 2025; DCCEEW, 2025; WattClarity, 16 Dec 2025)

1. What problem is the Review trying to solve?

The Review's diagnosis is that the NEM's operational dispatch has worked well, but the link between spot prices and *forward* contracting (risk management and investment) has not consistently delivered timely, credible investment signals; instead, new investment has often been driven by adjacent government schemes. Meanwhile, the transition to a more weather-dependent supply mix is increasing the value of robust hedging and forward price discovery, at the very time that traditional sources of liquidity (thermal plant) are exiting. (NEM Review Panel, 2025, pp. 28, 60)

The Review is explicit that future price formation will be driven by very low SRMC renewables, the opportunity cost of energy-constrained resources (batteries, hydro, pumped hydro), and the price sensitivities of consumer and distributed resources. In that world, "hidden" price-responsive demand and storage can undermine forecasting and weaken the integrity of price formation unless it is either visible or actively participating in dispatch. (NEM Review Panel, 2025, p. 69)

On the medium/long-term investment side, the Review argues that spot and derivatives markets alone have not produced long-dated signals in practice and that a "hybrid" design is required—retaining strong short-term operational incentives while adding a durable long-term contracting architecture that is economically connected back to the market. The proposed ESEM is the centrepiece of that architecture. (NEM Review Panel, 2025, pp. 16, 174–176)

2. My starting point as an economist of regulation

I have long taken the view that competition is not a box-ticking count of firms but a *process* whose virtue lies in discovery—innovation, entry, and rivalry that disciplines incumbents. Conversely, regulation that becomes an exercise in substituting officials' judgements for commercial decisions risks taking responsibility away from the market and producing unintended consequences

I am also wary of reforms justified by confident modelling where evidence is thin. In electricity—where incentives, bidding strategies and contractual structures interact in complex ways—overconfidence in "designing" outcomes can easily outrun what we can actually know. That is precisely why I generally favour incremental, testable reforms that strengthen the market process rather than replace it. (Littlechild, n.d.)

Finally, a regulator's comparative advantage is to create credible rules of the game—stable enough for investment, flexible enough to adapt—with a continuing process of evaluation and adjustment as markets evolve. That principle matters greatly if you adopt an ESEM and an MMO: the governance must be codified, disciplined, and reviewable. (Littlechild, n.d.)

3. What the Review recommends—and how I would advise you to respond

Recommendation 1: Keep the energy-only spot market (and avoid big-bang redesign)

The Review's first recommendation is blunt and, in my judgement, right: retain the real-time regional energy-only spot market (with necessary rule changes), and *do not* create additional mandatory centralised short-term markets (capacity markets or physical ahead markets), *do not* implement locational marginal pricing, and *do not* create distribution-level wholesale markets. It explicitly treats greater volatility as manageable within an energy-only design. (NEM Review Panel, 2025, p. 69)

My advice is that you should treat this as the "constitutional" decision in the package. Make it explicit—publicly—that government is choosing to strengthen the existing market rather than replace it with administratively heavy alternatives. That single commitment reduces sovereign-risk perceptions for investors and helps keep every other reform (MMO/ESEM/consumer measures) interpreted as market-supporting rather than market-supplanting. (NEM Review Panel, 2025, pp. 69, 16–17)

Recommendation 2: Bring more price-responsive resources "into view" or dispatch

The Review recommends a mandatory framework for price-responsive resource (PRR) visibility and participation: AEMO to develop the framework by December 2026; ministers to progress NEL/NER amendments to enable implementation by 2030; with initial thresholds including >5MW aggregated small-scale storage (without co-located load) required to participate in dispatch (active) or as a bidirectional unit, and >30MW CER aggregations with remote automated control required to participate in dispatch mode (inactive). (NEM Review Panel, 2025, p. 69)

The Review also recognises practical limits—e.g., for pool-price pass-through and contingent demand response contracts—so it shifts toward regular information provision to improve forecasting, rather than forcing impractical dispatch obligations immediately. It also urges ministers to progress NEL amendments in parallel so a full framework can be implemented by 2030. (NEM Review Panel, 2025, p. 107)

I would support this direction, but with two ministerial disciplines. First, insist that "visibility" is designed to be *fit-for-purpose* and not a bureaucratic data-grab—because excessive compliance cost will simply push innovation outside the market framework. Second, ensure the support/incentive framework for non-scheduled PRR is tightly linked to demonstrated system benefits, because otherwise you risk subsidising participation that would have happened anyway. (NEM Review Panel, 2025, pp. 69, 107–108)

Recommendation 3: Make consumer and distributed resources genuinely price-responsive

The Review's third recommendation is to "unlock the full benefits of more consumers becoming price-responsive" by focusing reforms and any incentives for consumer energy resources on enabling market participation through aggregators and "dynamic network connections" (dynamic

operating envelopes), rather than simply adding more subsidised kit behind the meter that cannot respond to system conditions. (NEM Review Panel, 2025, p. 70)

I agree with the intent, but I would caution you against assuming that ever more granular dynamic pricing is the only route to consumer benefit. The Review itself later observes that most consumers value simplicity and stability. The right ministerial stance is: enable sophisticated participation for those who want it (and for aggregators), while keeping simple products viable for the majority. (NEM Review Panel, 2025, pp. 70, 242–247)

Recommendation 4: Fix emerging spot-market issues (bidding, batteries, outages)

The Review asks market bodies to use the rule-change process to address emerging issues, including bidding practices, battery state-of-charge visibility and algorithmic bidding, and the impact of transmission outages on the spot market. It points, for example, to the AER/AEMC/AEMO work to replace the suspended "market impact component" and to ongoing scrutiny of whether constraints affect competition and drive high spot prices. (NEM Review Panel, 2025, pp. 119–120)

My advice is to make this a *competition and transparency* agenda, not a "micro-manage bidding" agenda. Bad rules often invite gaming; good rules make gaming less profitable. Where you intervene, do so with a clear theory of harm and require post-implementation evaluation so that changes are not left to calcify. (NEM Review Panel, 2025, pp. 119–120; Littlechild, n.d.)

Recommendation 5: A long-term view of market price settings

The Review recommends that the Reliability Panel provide an ongoing long-term outlook on the *form* of market price settings (MPC, MPF, CPT, APC) and conduct a 2026 review to provide an initial long-term outlook (up to 15 years), while keeping these settings linked to VCR and revenue adequacy for efficient investment in bulk energy, shaping and firming. (NEM Review Panel, 2025, p. 122; pp. 23–24)

Here, I would urge you to treat "price settings" as part of the wider contracting ecosystem. If you alter caps/floors/thresholds without regard to how contracts are written and traded, you can easily destabilise investment incentives. The Review usefully sequences this alongside contract co-design, the MMO, and the ESEM. That sequencing is sensible and should be maintained. (NEM Review Panel, 2025, p. 16)

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4. The derivatives package: MMO, contract co-design, prudential and MT PASA

Recommendation 6: A permanent market-making obligation (MMO)

The Review proposes a permanent MMO framework in the NEL/NER for a small number of key derivative contracts, designated and managed by the AER, triggered only when objective liquidity thresholds are breached, with an immediate focus on South Australia (initially cap contracts), and with a ministerial opt-out power for a region. It also proposes that voluntary market makers (e.g., trading firms) can participate, but must comply with the same bid-offer spreads in MMO windows. (NEM Review Panel, 2025, pp. 23–24, 150)

This is a significant intervention, and my advice is: **support it as a "tool in the toolbox" rather than a permanent substitute for commercial liquidity**. The Review itself justifies it by pointing out that voluntary market-making can evaporate under stress, and it draws on UK and New Zealand experience with mandatory market-making schemes. The design feature you should defend politically is precisely the "triggered" nature: obligations apply where and when liquidity is demonstrably inadequate, not as a broad permanent constraint on trade. (NEM Review Panel, 2025, pp. 144, 150)

My concrete ministerial conditions would be: (i) the AER's liquidity thresholds must be published, objective, and periodically reviewed; (ii) the costs and any unintended consequences (e.g., widening spreads outside MMO windows, reduced bespoke contracting) must be evaluated; and (iii) opt-out should be time-limited and require a public statement of reasons, otherwise you risk undermining national liquidity goals through regional politics. (NEM Review Panel, 2025, pp. 23–24, 150)

Recommendation 7: Industry-led contract co-design (with CEFC included)

The Review proposes that the AER and the ESEM Administrator regularly convene an industry-led co-design process (e.g. every four years) to define a small set of core derivative contracts underpinning trading, the MMO and the ESEM, with CEFC as a standing participant. The report is explicit that product innovation should be driven by market participants and experienced commercial staff. (NEM Review Panel, 2025, pp. 24, 155)

I would support this strongly, because it is the least bureaucratic way to solve a genuine coordination failure: buyers and sellers need standard products to trade, but no one party can force standardisation without some convening mechanism. Your role, as minister, is to ensure the convenor does not become the designer: if officials take over product design, you will drift into "regulation as substitution for commercial judgement". (NEM Review Panel, 2025, pp. 155–156; Littlechild, n.d.)

Recommendation 8: Counterparty risk and prudential

The Review recommends a multi-agency review of counterparty risk management and prudential arrangements. This is unsurprising: as liquidity shifts between exchange and OTC markets, and as new entrants appear with different balance sheets, prudential settings can become either (a) a barrier to entry and competition, or (b) too loose to protect the system. (NEM Review Panel, 2025, p. 25)

My advice is to insist that the prudential review be framed as: *risk management that preserves entry and rivalry*. A prudential regime that only looks at "safety" can easily entrench incumbents. Require the review to explicitly analyse impacts on smaller retailers, independent generators, and innovative intermediaries—because these are precisely the parties that keep pressure on retail pricing. (NEM Review Panel, 2025, pp. 60, 198)

Recommendation 9: Extend and publish MT PASA availability to 5 years

The Review recommends a rule change to extend and publish generator availability MT PASA projections from three to five years. This is intended to help longer-term hedging, price discovery, and investment planning—especially in a system facing significant thermal exits. (NEM Review Panel, 2025, p. 25)

I would support this, but I would ask AEMO (and the AER) to specify clearly what information is published, at what granularity, and with what safeguards against strategic behaviour. Transparency is valuable, but "naïve transparency" can sometimes increase gaming. That is a design detail you should not leave unattended. (NEM Review Panel, 2025, pp. 25, 233)

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5. The ESEM: my support is conditional on governance, scope discipline, and market linkage

Recommendation 10: Establish the ESEM in the NEL/NER

The Review proposes the ESEM as an "evolution, not revolution": it builds on existing underwriting schemes but shifts to standardised service-based contracts (bulk energy, shaping, firming),

embedded in the national framework, systematically returned ("recycled") to the market prior to maturity, with an "in-market" period (no less than three years) before ESEM contracting begins (e.g., years 4–15). It aims to commence by FY2027 (pilot late 2026; full commencement early 2027). (NEM Review Panel, 2025, pp. 178–179)

The Review's stated purpose is to address the "tenor gap" by creating long-term price curves for services, while keeping those services available to retailers and large customers to manage spot-price risk; and by reducing the need for the administrator to "forecast" by using fungible contracts and competitive, price-based procurement. It also stresses that the ESEM Administrator must be guided by a robust risk management framework and strong governance "enshrined in legislation". (NEM Review Panel, 2025, pp. 197–201)

My advice is: **endorse the ESEM concept, but legislate it as a market-facilitating institution, not a discretionary planner**. The Review itself leans in this direction—emphasising technology neutrality, simple price-based competitive processes, and systematic recycling to build liquidity. You should hold the system to that discipline. (NEM Review Panel, 2025, pp. 186, 178–179)

Concretely, I would advise you to insist on six "guardrails" before committing political capital to legislation:

1. **Codified trajectory-setting** with transparent consultation, limited jurisdictional input to correct interpretation of targets (not ad-hoc interference), preserving what the report calls the "automatic stabiliser" effect. (NEM Review Panel, 2025, p. 191)

2. **Strict separation of roles**: the ESEM Administrator procures; the AER regulates; the AEMC sets rules; ministers set targets—do not blend these. (NEM Review Panel, 2025, pp. 191–192)

3. **Competition protections**, including market concentration thresholds for ESEM participation independently set by the AER (not by political discretion). (NEM Review Panel, 2025, p. 217)

4. **Risk management and transparency**, including a published risk policy for recycling and clear accounting of exposures, because the ESEM will hold material positions. (NEM Review Panel, 2025, p. 201)

5. **Compatibility with private contracting**: ensure the ESEM does not crowd out bespoke PPAs/virtual tolls; the Review's "engagement modes" (including buy-back/pivot) are meant to preserve commercial flexibility—protect that. (NEM Review Panel, 2025, pp. 199–200)

6. **A credible implementation plan and resourcing**, because a half-built ESEM is worse than none: it creates policy uncertainty without delivering liquidity or investment signals. (NEM Review Panel, 2025, p. 178; p. 238)

Recommendation 11: Align other policies and frameworks with the ESEM

The Review is right to insist the ESEM will not work in isolation. It recommends, among other things: clarify how emissions targets apply to firming projects; task ARENA (with CEFC and others) to accelerate zero-emissions firming; improve derivatives liquidity within existing underwriting schemes; review interconnector hedging arrangements (including potentially extending the timeframe for settlement residue units beyond three years); phase out the RRO once the ESEM/MMO are working; rationalise forecasting and planning documents; and improve consistent treatment of load/storage/generation across distribution and transmission. (NEM Review Panel, 2025, p. 26; pp. 173–174)

My advice is to treat Recommendation 11 as the political "deal" that makes Recommendation 10 viable. In particular, the commitment to phase out the RRO once the ESEM/MMO are effective is important: piling new mechanisms atop old ones is how markets become incoherent. The Review's critique is that the RRO is near-term and does not address the tenor gap, so it is poorly suited to long-term reliability investment. (NEM Review Panel, 2025, p. 233)

Recommendation 12: Implement quickly and resource properly

The Review recommends implementing the package expeditiously and resourcing market bodies to run implementation activities concurrently with legislative processes. In practice, this is an instruction to you: do not announce "in principle" support without immediately funding and tasking the institutions to deliver. (NEM Review Panel, 2025, p. 174; p. 238)

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6. Ensuring consumers benefit: the Review's four "Observations" are politically central

Although labelled "Observations", I would not treat these as optional extras. They are the consumer-facing narrative that prevents this package being seen as a technocratic reconstruction of wholesale markets for the benefit of market participants.

Observation 1 (multi-year fixed retail contracts): the Review suggests supporting simple multi-year fixed-price contracts; removing regulatory barriers; enabling better consumer tools (Energy Made Easy); publishing benchmark cost stacks up to five years; and reviewing early exit fee restrictions to ensure they do not impede efficient fixed-price offerings. (NEM Review Panel, 2025, pp. 242–247)

My advice: this is a sensible complement to the wholesale reforms. If you are asking markets to endure more volatility, it is politically prudent to make it easier for households and SMEs to buy stability, while still allowing sophisticated customers to take more exposure if they wish. The retail end should not be forced into one model. (NEM Review Panel, 2025, pp. 242–247)

Observation 2 (network tariff structures): the Review points toward more fixed-price structures based on capacity use (highest use at times of high demand), with dynamic tariffs for those purchasing aggregation services, and recovery of residual costs via fixed charges rather than generalised ToU volumetric charges—while explicitly flagging equity and distributional impacts. (NEM Review Panel, 2025, p. 261)

My advice: do not let network tariff reform become a moral crusade for "cost reflectivity" at the expense of comprehension. A tariff that is theoretically elegant but politically unintelligible will not survive—and the resulting policy churn is poison to investment. (NEM Review Panel, 2025, p. 261; Littlechild, n.d.)

Observation 3 (DMO methodology): the Review notes the DMO "book-build" approach influences hedging strategies and suggests revisiting it so benchmarking reflects the new longer-dated, standardised instruments delivered through co-design and the MMO—supporting stable longer-term pricing for consumers. (NEM Review Panel, 2025, p. 261)

My advice: if you change the wholesale architecture (MMO/ESEM), you must align retail benchmarking methodologies or you will get perverse incentives and claims of "price gouging" that are really artefacts of inconsistent regulatory settings. (NEM Review Panel, 2025, p. 261)

Observation 4 (NECF extension and a consumer duty): the Review suggests extending the National Energy Customer Framework to cover new energy services (including CER aggregation) and exploring an overarching consumer duty as service offerings become more complex. (NEM Review Panel, 2025, pp. 262–263)

Here I would be cautious. A broad "duty" can become a vague standard that encourages defensive behaviour and inhibits innovation—particularly for new entrants. If pursued, it should be tightly specified, proportionate, and designed to support competition rather than to create a litigation-driven culture of risk avoidance. (NEM Review Panel, 2025, pp. 262–263; Littlechild, n.d.)

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7. What I would do in your position: a ministerial action agenda

If you want this package to succeed, you must treat it as an integrated reform program with disciplined governance. On that basis, I would advise the following immediate ministerial actions.

First, lock in the constitutional commitments: publicly reaffirm Recommendation 1 (energy-only, no capacity market, no LMP, no distribution wholesale markets) to reduce investor uncertainty and stop the policy debate constantly reopening foundational design questions. (NEM Review Panel, 2025, p. 69)

Second, start the "long-lead" technical work now: task AEMO formally on the PRR framework to meet the December 2026 deadline; ask the Reliability Panel to prepare the 2026 market price settings review scope; and instruct the AER/AEMC to commence preliminary MMO/co-design design work (even before legislation) so implementation can run in parallel. (NEM Review Panel, 2025, pp. 69, 122, 155)

Third, treat ESEM governance as the main political risk: if you proceed, legislate strong guardrails—codified trajectory setting, transparent recycling/risk rules, competition thresholds, and narrow discretion—because otherwise the ESEM will be attacked (not unreasonably) as central planning by another name. (NEM Review Panel, 2025, pp. 178–179, 201, 217)

Fourth, resource the institutions and insist on evaluation: the Review is explicit that implementation should be resourced and concurrent with legislative processes. Require formal post-implementation reviews of PRR participation, MMO impacts (liquidity, spreads, entry), and ESEM outcomes (costs, liquidity, investment timing). Regulation without evaluation tends to accumulate, not improve. (NEM Review Panel, 2025, p. 238; Littlechild, n.d.)

Fifth, make consumer outcomes visible early: do not wait for wholesale reforms to land before acting on retail simplicity and stability. If you can remove barriers to multi-year fixed offers and improve transparency of benchmark cost stacks, you will have a tangible consumer narrative while the wholesale machinery is being built. (NEM Review Panel, 2025, pp. 242–247)

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8. My bottom line

I would advise you to support the Review's direction because it is, at least in intention, a strengthening of the original NEM settlement: an energy-only dispatch market supported by contracting and competition—updated for a world of storage, demand response and weather-driven volatility, and with an explicit attempt to rebuild long-term price discovery. (NEM Review Panel, 2025, pp. 8, 16–17, 28)

But my support is *conditional*: the MMO must remain a targeted, threshold-triggered backstop; the ESEM must be tightly governed and market-linked (with minimal discretion and strong competition protections); and the consumer agenda must not be treated as an afterthought. If you let discretion expand, or allow multiple overlapping mechanisms to persist indefinitely, you will end up with an administratively constructed market that neither disciplines costs nor commands legitimacy. (NEM Review Panel, 2025, pp. 23–24, 178–179, 233; Littlechild, n.d.)

QUESTION: I am not an expert, I want your critique of the National Electricity Market (NEM) Wholesale Market Settings Review. Document attached:

SCL RESPONSE:

You have asked for a critique in **non-expert** terms. I shall therefore do two things: first explain, plainly, what this Review is trying to accomplish; then set out where I think it is sound, where it is fragile, and what I would insist upon if governments adopt its proposals.

What the Review is trying to do, in plain English

The Wholesale Market Settings Review is trying to keep the NEM's *core* strengths (a real-time spot market for dispatch and pricing) while adapting to three big changes: (i) far more wind/solar (so prices are more weather-driven), (ii) far more batteries and flexible demand (including behind-the-meter) that can respond to price but are not always visible to the operator, and (iii) the retirement of coal, which historically underpinned much of the medium-term hedging/contract market. The Review explicitly frames the consumer problem as *price volatility flowing through to bills*, and it presents its reform package as a way to reduce risk premia and improve competition so that retail offers can be simpler and more stable. (NEM Review Panel, 2025, Executive summary; ; DCCEEW, "NEM wholesale market settings review", last updated 2 Jan 2026;)

Two diagnoses are central. First is a **visibility gap**: a growing class of "hidden participants" (consumer energy resources, flexible demand, aggregations, automated bidding) can move supply/demand materially, but their behaviour is not fully visible in real time to AEMO and other participants, which undermines forecasting and can create system risks. Second is a **tenor gap**: investors in long-lived assets often need long-dated revenue certainty, but the traded/transparent part of the hedge market is typically much shorter and in some regions (notably SA) appears thin and concentrated; this can push the industry toward vertical integration and weaken retail competition. (NEM Review Panel, 2025, Executive summary;)

My general yardstick, before we get into details

In my own work on electricity reform, I have consistently argued that we should give a **greater role to the market vis-à-vis regulation** than is often accepted, and that reform should be assessed by comparing feasible institutional alternatives rather than against an "ideal" benchmark ("nirvana fallacy"). That is not an ideological slogan; it is a practical warning that every new central mechanism creates its own incentives, lobbying, and unintended consequences. (Littlechild, *Foreword: The Market versus Regulation*;)

That yardstick matters here because the Review contains two impulses in tension: on the one hand it **defends the energy-only spot market** and rejects several fashionable redesigns; on the other hand it proposes an ambitious new long-term procurement/contracting construct (the ESEM) that risks re-centralising parts of what the NEM was built to decentralise. (NEM Review Panel, 2025, Recommendations 1 & 10;)

Where I think the Review is strongest

1) It resists “big bang” market redesign

Recommendation 1 is, in my view, the most valuable part of the Report: it explicitly **retains the real-time regional energy-only spot market** and says *do not* add mandatory capacity markets or physical ahead markets; *do not* implement locational marginal pricing; and *do not* create distribution-level wholesale markets. It instead prefers bringing distributed resources into the existing regional market, using dynamic operating envelopes and dynamic network tariffs for local constraints. That is a strong presumption in favour of continuity and incrementalism, and it avoids years of design churn. (NEM Review Panel, 2025, Recommendation 1;)

This restraint is economically sensible. The Review is right that volatility is not, by itself, a “market failure”: in an energy-only market, scarcity must sometimes show up as high prices, otherwise you do not get the right signals for entry, availability, demand response, and hedging. If consumers want stable bills, the primary instrument should be **contracting and retail product choice**, not suppressing spot prices by redesigning the spot market into something more administrative. The Report’s emphasis on the derivatives market as “scaffolding” for risk transfer is exactly the right direction of travel. (NEM Review Panel, 2025, Executive summary and derivatives discussion;)

2) It squarely identifies the operational visibility problem

The Review’s account of “hidden” price-responsive behaviour is compelling: if a growing share of flexibility can move quickly but remains outside dispatch/visibility frameworks, then both efficiency and security suffer. The proposed direction—widening visibility modes and bringing larger aggregations into dispatch-adjacent obligations—targets a genuine coordination problem rather than just “high prices”. (NEM Review Panel, 2025, Executive summary; ; NEM Review Panel, 2025, Recommendation 2;)

Where I think the Review is weakest, or at least most risky

3) It sets “stable bills” as a policy lodestar, and that can tempt bad interventions

The Commonwealth material around the Review repeatedly stresses “addressing price volatility” and delivering “more predictable, stable bills”. Politically, that is understandable. Economically, it is dangerous if it morphs into an expectation that *wholesale* prices should be stable. Wholesale prices in a weather-dependent system are unlikely to be stable, and trying to make them so typically substitutes hidden rationing or expensive out-of-market interventions for transparent scarcity. (Minister Bowen media release, 6 Aug 2025; ; DCCEEW webpage, updated 2 Jan 2026;)

To the Review’s credit, it mostly does **not** recommend suppressing scarcity pricing; it recommends improving the contracting architecture so retailers can offer stability. But one must watch carefully for “consumer stability” rhetoric becoming a justification for ad hoc caps, directions, and bespoke support schemes that ultimately **increase regulatory risk** and thereby widen (not shrink) the risk premia embedded in contracts. The Report itself aspires to “reduced reliance on ad hoc government interventions” and “increasing policy predictability”; that aspiration is correct, but the package must be judged by whether it truly delivers it. (NEM Review Panel, 2025, Vision and principles;)

4) The proposed PRR/CER visibility framework is directionally right—but could become over-prescriptive

Recommendation 2 proposes a mandatory framework by 2030, with AEMO to design by Dec 2026, including thresholds for mandatory participation (e.g., >30 MW remote-controlled CER aggregation into dispatch mode (inactive), etc.). Conceptually, I support moving material “hidden” flexibility into visible frameworks. (NEM Review Panel, 2025, Recommendation 2;)

My caution is about the **regulatory style**. In a fast-moving area (aggregation, VPPs, automated optimisation), a danger of premature or heavy-handed regulation is that intermediary and innovative activities that could benefit customers get "prevented, discouraged or unduly constrained". I have made exactly that argument in another context (third-party intermediaries): regulators often assume intermediaries will become a "problem" and that "more regulation will be the answer", before the evidence is in. The Review itself tries to mitigate this with multiple "modes" (active/inactive/visibility-only), but the implementation could still drift toward box-ticking compliance rather than discovery and innovation. (Littlechild, discussion of premature regulation; ; NEM Review Panel, 2025, PRR participation modes;)

So, if governments proceed, I would insist on two disciplines: (i) **proportionality and cost-benefit** for each increment of visibility/data obligation, and (ii) a bias toward **outcomes** (forecast error reduction, reduced intervention volumes, measurable operational benefits) rather than mandating specific technical architectures that will be obsolete before 2030. The Review cites large potential benefits from visibility/dispatch of PRR; those benefits should be made testable and ex post reviewable. (NEM Review Panel, 2025, benefit discussion around PRR;)

5) Market making and "core contracts": useful, but inherently interventionist—so it must be tightly bounded

The Review's derivatives diagnosis is credible: spot volatility increases the value of hedging; coal exit removes a traditional source of standard hedges; SA already shows lower traded volumes relative to demand and greater concentration; and OTC innovation does not necessarily help smaller participants or price transparency. (NEM Review Panel, 2025, liquidity discussion;)

Against that, Recommendation 6 proposes a **Market Making Obligation (MMO)** framework, triggered by the AER against objective liquidity thresholds, initially in SA; Recommendation 7 proposes an industry co-design group for "core contracts". The Report draws on UK/NZ experience and notes that mandatory market making in the UK was later repealed when market structure changed. This is exactly the right historical lesson: market making can be a **temporary scaffold**, but it can also become a permanent regulatory crutch. (NEM Review Panel, 2025, international experience and MLO/MMO discussion; ; NEM Review Panel, 2025, Recommendation 6/7 description in report;)

My critique is therefore conditional. A well-designed market making backstop can reduce entry barriers and frustrate vertical foreclosure. But it can also: (i) entrench particular products and trading venues, (ii) shift risk/cost onto mandated firms and ultimately consumers, and (iii) crowd out private intermediation. I would treat the MMO as acceptable only if it has (a) **clear triggers**, (b) **region-specific application** where the problem is evidenced, and (c) an explicit **sunset / periodic re-justification** so that, as in the UK case, it can be repealed when no longer needed. (NEM Review Panel, 2025, market making case studies;)

6) The consumer "benchmark cost stack" idea repeats a mistake I have seen before

In its consumer chapter, the Review floats (Observation 1) the idea that the AER could publish "benchmark cost stacks" (up to five years ahead) to guide retail offers and help consumers decide on fixed-price contracts; it also contemplates an "inner market" safe harbour built on benchmark pricing, alongside an "outer market" with more sophisticated products and a consumer duty. (NEM Review Panel, 2025, Observation 1 and inner/outer market discussion;)

Here I am distinctly sceptical, because I have watched regulators slide from "transparency benchmarks" into **de facto price control by benchmark**. In my critique of the GB retail energy market investigation, I argued that the CMA's "competitive benchmark price" became a highly idealised hypothetical construct, comparing actual prices to what an imagined efficient supplier would charge in a "steady state", and that this approach sits uneasily with the principle that competition is a **process of rivalry** (variety, innovation, different costs and prices across firms). A

regulator-published benchmark can easily become the focal point for political and media pressure ("why are you above the benchmark?"), thereby discouraging tariff innovation and legitimate product differentiation. (Littlechild, critique of "competitive benchmark price" construct; ; NEM Review Panel, 2025, Observation 1;)

If Australia wants consumers to have access to simple multi-year fixed contracts, the more robust route is to make sure wholesale hedging markets are liquid and entry barriers are low—*then let competition discover the offers*—rather than having the regulator publish a forward "cost stack" that risks becoming a normative price anchor.

The pivotal issue: the ESEM

7) The ESEM is a bold attempt to patch the "tenor gap"—but it risks becoming central planning by another name

Recommendation 10 proposes an **Electricity Services Entry Mechanism (ESEM)** within the NEL/NER, to facilitate long-term investment and act as a successor platform after the Capacity Investment Scheme tends to conclude. The design involves a new ESEM Administrator procuring standardised, tradeable, financial derivative contracts for "bulk energy", "shaping", and "firming" services—particularly for the later years of project life—then warehousing those contracts until market liquidity supports "recycling" them back into the market. The Review also envisages the ESEM being used (in some form) for procuring essential system services (ESS) and strategic reserves, with complex interfaces to TNSPs and RIT-T in some cases. (NEM Review Panel, 2025, Recommendation 10 and contract warehousing/recycling; ; Minister Bowen media release, 26 Nov 2024 (review to inform post-CIS settings);)

My critique is not that long-term contracting is unimportant—on the contrary, it is crucial. My critique is that an ESEM can easily drift into **a quasi-central buyer/seller of long-term risk**, and that changes the political economy of the NEM. Once a central mechanism is procuring "anticipated entry trajectories" (even if guided by reliability standards and emissions targets), participants will rationally redirect effort from competing in markets toward influencing the trajectory, contract definitions, eligibility criteria, and tender parameters. The Review recognises the risk of over-procurement and calls for robust, transparent methodologies; that is necessary, but it does not eliminate the information problem. (NEM Review Panel, 2025, trajectory methodology discussion;)

8) The ESEM's success depends on something the Report cannot guarantee: credible limits on discretion and political influence

The Review proposes governance, risk management and statutory architecture for the ESEM Administrator, and it proposes competition screens (AER-set concentration thresholds) for eligibility criteria. These are sensible safeguards on paper. (NEM Review Panel, 2025, ESEM governance and competition thresholds;)

But the decisive question is whether the ESEM can be kept as a *limited bridge* rather than becoming the default route to investment. In my experience, governments seldom resist the temptation to expand discretionary instruments once created, especially when the stated political objective is "stable bills". I have also warned elsewhere that increased governmental influence and intervention can reduce the speed and quality of market decision-making and discourage innovation. Those risks are not theoretical here: they are precisely what a central procurement entity can import unless its remit is tightly fenced. (Littlechild, concerns about increased government influence and innovation; ; NEM Review Panel, 2025, vision to reduce ad hoc interventions while introducing ESEM;)

9) Contract standardisation is helpful; contract *mis-specification* is fatal

A further risk is technical but important. The ESEM relies on defining a small set of standardised contracts for bulk energy, shaping and firming, and the Report notes preferences emerging from a pilot process (caps for firming; dispatch-weighted swaps and “heads and tails” spreads for other services), while acknowledging debate about whether “one size fits all”. If the standard contracts are mis-specified—i.e., they do not align with how technologies actually create value—then the ESEM will procure the wrong things, distort operational incentives, and fail to recycle contracts into a liquid secondary market. (NEM Review Panel, 2025, ESEM contract discussion;)

This is why I regard Recommendation 7 (industry co-design of core contracts) as more important than it might appear: contract design is where markets embed knowledge. But if co-design becomes dominated by incumbents (or by policy preferences dressed up as “service definitions”), the ESEM could end up entrenching the very concentration and entry barriers it is supposed to relieve.

What I would recommend, if governments take this package forward

10) Treat the package as “market strengthening”, not “market replacement”

I would implement the visibility reforms and derivatives liquidity measures first, and evaluate them rigorously before expanding any central procurement role. The Review itself says interventions should “strengthen, not supplant” the core mechanisms, and it frames interventions as proportionate responses to barriers the market cannot solve alone; that principle should be operationalised as sequencing and gating, not merely stated. (NEM Review Panel, 2025, principles;)

11) If the ESEM proceeds, I would insist on five hard constraints

First, **a narrow statutory purpose** (explicitly limited to addressing the identifiable tenor gap), with a presumption that the ESEM winds back as private liquidity develops.

Second, **transparent triggers and procurement volumes**, with an explicit requirement to justify why private contracting cannot deliver the same outcome at lower long-term cost/risk.

Third, **independence and non-discrimination**: the Administrator must not become a vehicle for technology favourites beyond what is already embodied in democratically agreed targets; special tenders for technology-specific targets are particularly prone to politicisation unless tightly justified. (NEM Review Panel, 2025, special tenders and targets statement link;)

Fourth, **ex post evaluation** against measurable metrics: long-dated forward curve liquidity, entry of non-integrated retailers, reduction in OTC access premia, and demonstrated recycling success (warehouse → tradeable market instruments).

Fifth, **a credible exit**: a sunset clause or a scheduled re-authorisation (with a high evidentiary bar), so the ESEM does not become a permanent semi-planned layer of the NEM.

12) Beware “benchmarks” that become price control

Finally, I would keep consumer protection focused on preventing mis-selling and ensuring fair dealing in complex services, but I would be cautious about regulator-published forward “benchmark cost stacks” becoming the benchmark against which competitive offerings are judged. That approach is too easily converted into a political instrument, and it misunderstands the nature of competition as rivalry and discovery rather than convergence to a single “correct” price. (NEM Review Panel, 2025, Observation 1 and benchmark discussion; ; Littlechild, critique of benchmark constructs in retail energy;)

A brief note on “what is happening now” (post-report)

Official government pages confirm the final report was published on the Energy Ministers’ site on 16 December 2025, and the Commonwealth has framed the review as identifying post-CIS settings and addressing price volatility. Media reporting (quoting a ministers’ communique) indicates ministers agreed “in principle” to the core recommendations, with Queensland not giving in-principle agreement, and that officials were tasked to develop a work program by February 2026 with an aim of having ESEM in place by end-2027. I cannot independently verify the communique text itself because the official communique file could not be retrieved by my web tool, so I treat this as *reported* rather than definitive. (energy.gov.au, “NEM wholesale market settings review”, 16 Dec 2025; ; Minister Bowen media releases 2024–2025; ; RenewEconomy report quoting communique;)

Bottom line

My judgement is that the Review is at its best when it **defends the existing energy-only spot market** and proposes pragmatic steps to make flexibility visible and to keep hedging markets liquid and contestable. It is at its most questionable where it moves toward **centralised long-term procurement (ESEM)** and where it toys with **regulatory benchmarks** that can become de facto price control. If the ESEM is pursued, it must be fenced as a limited, testable, and ultimately reversible mechanism—otherwise it risks recreating, under a new name, the very central planning dynamics that liberalisation was meant to escape. (NEM Review Panel, 2025, Recommendations and principles; ; Littlechild, *Foreword: The Market versus Regulation*;)

If you tell me what you most care about—**prices/bills**, **reliability**, or **the energy transition pace**—I can re-read the relevant chapters through that lens and give you a more targeted critique of the specific recommendations that matter most to you.

QUESTION: I am an official in the Department of Energy. I want your critique of the National Electricity Market (NEM) Wholesale Market Settings Review. Document attached:

SCL RESPONSE:

You are asking me to critique the *National Electricity Market (NEM) Wholesale Market Settings Review – Final Report* (released 16 December 2025), written for Energy Ministers and directed at wholesale-market settings "following the conclusion of CIS tenders in 2027". (Nelson et al., 2025; DCCEEW, 2025).

I shall be explicit about the criterion I use. Long ago, when advising on electricity reform, I wrote that *"The ultimate criterion by which regulation is to be judged is its effectiveness in protecting the customer."* I also argued that *"Competition is the most effective means of discovering and meeting customer preferences, stimulating efficiency and ensuring that the benefits are indeed passed on to customers."* Those propositions remain the right starting point for assessing any market redesign in electricity: does it strengthen the discovery process and constrain monopoly power, or does it substitute administrative judgement for market discipline in ways that will later harm customers? (Littlechild, 1988).

What the Review gets right

The Review is at its strongest where it resists the urge to "redesign everything" and instead reaffirms the core merit of the NEM: a real-time, regional, energy-only spot market providing dispatch and scarcity signals. Recommendation 1 is admirably clear: **retain the real-time regional energy-only spot market**, **do not** add mandatory short-term capacity markets or physical ahead markets, **do not** adopt locational marginal pricing variants, and **do not** create distribution-level wholesale markets (instead enabling distribution resources to participate in regional markets). That is broadly the correct direction: incremental repair rather than wholesale replacement. (Nelson et al., 2025, p. 69).

I also agree with the Review's insistence that the market exists to serve consumers and should be judged by whether it delivers reliable electricity at fair, stable and affordable prices. That is not mere rhetoric: it is a necessary discipline on market bodies and ministers alike, because every "clever" intervention can be justified as "for consumers" unless one demands demonstrable, durable consumer benefit. (Nelson et al., 2025, pp. 66–68).

The Review is also right to describe the NEM as an integrated physical-and-financial system: spot prices guide dispatch; derivative contracts manage risk and (in principle) guide entry and exit. The central problem it identifies—strain in forward markets as thermal exits reduce traditional hedge supply and as volatility increases—is real and needs attention if one wants to preserve an energy-only market with decentralised investment. (Nelson et al., 2025, pp. 31–34).

Where the Review is most vulnerable: "hybrid" markets and the drift to central direction

The Review's broad narrative is that the NEM needs "hybrid" long-term investment mechanisms layered onto an energy-only operational market, because spot+derivatives "alone" have not

delivered timely investment signals and because buyers will not sign the long tenors sellers need (the “tenor gap”). This is the point at which the Review moves from incremental repair into institutional invention: the proposed Electricity Services Entry Mechanism (ESEM), a long-term contracting and warehousing institution embedded in the NEL/NER. (Nelson et al., 2025, pp. 14–16, 174).

My concern is not that government should *never* act. It is that, once you create a central buyer/warehouse of long-dated electricity “services”, you are inevitably re-introducing an element of central planning—setting quantities, defining products, influencing technology mix—while simultaneously retaining the rhetoric of “market-linked” outcomes. That combination is politically attractive and economically dangerous: it can weaken market discipline yet still diffuse responsibility (“the market did it”, “the administrator did it”, “ministers did it”). (Nelson et al., 2025, pp. 179–191).

This is not an abstract worry. In earlier work on electricity reform, I contrasted approaches that *avoid central direction* with those that entrench it. I wrote approvingly that “the present scheme envisages no such central direction”, and argued that *“Private ownership and the multiplicity of competing decision-makers is likely to lead to faster and more accurate response to changing market conditions (especially bearing in mind the vulnerability of nationalised industries to official government forecasts)… On balance, it seems likely that private ownership, without central planning, will provide a pattern of investment… more efficient, more cost-effective and more responsive to changing market conditions.”* (Littlechild, undated excerpt in corpus).

ESEM is, in effect, an attempt to keep the operational market decentralised while centralising part of the investment/contracting function. That may be the least-bad political compromise—but do not pretend it is simply “evolution”. It is a substantive shift in who underwrites long-term entry, how risk is allocated, and where lobbying effort will flow. (Nelson et al., 2025, pp. 179–201).

Recommendation-by-recommendation critique

Recommendation 1: retain energy-only spot market and resist new short-term mandatory markets

I support Recommendation 1, not because I believe spot markets are “perfect”, but because the alternatives (mandatory capacity markets, mandatory day-ahead scheduling, LMP variants) bring large governance burdens and can easily turn into administratively-managed systems with complex side payments and constant redesign. The Review itself recognises the operational “wrinkles” are manageable and that the costs/risks/complexity of alternatives likely outweigh benefits. (Nelson et al., 2025, pp. 68–69).

That said, an energy-only market is only as good as its willingness to let scarcity pricing and contracting do their job. One cannot continuously cap prices, intervene out-of-market, and then lament that forward markets are thin. The Review sometimes treats volatility as something to be “managed” rather than as a signal that needs to be *contracted around* and sometimes endured. This matters for ministerial messaging: if ministers continue to treat scarcity pricing as a failure rather than as the mechanism, investment will keep migrating to schemes and subsidies. (Nelson et al., 2025, pp. 31–34, 66–68).

Recommendation 2: mandate visibility/dispatch participation for price-responsive resources

The Review is right that hidden price-responsive resources (especially aggregated CER and flexible load) can degrade price formation and operational forecasts, and that better visibility can improve efficiency. It is also sensible that the Review explicitly tries to avoid “one size fits all” dispatch obligations and instead proposes tiered “visibility modes” matched to capability, to limit compliance costs and avoid undermining innovation. (Nelson et al., 2025, pp. 69, 100–102).

My caution is institutional: giving AEMO a minister-mandated programme to define thresholds and modes by 2026, with full implementation by 2030, risks becoming a ratchet. Each new category of participant will be "made visible" by rule; then visibility becomes participation; then participation becomes obligations akin to licensing. The Review says it does *not* require participants to go beyond modes that suit their capability, and that is welcome, but ministers should demand explicit guardrails: **(i)** a quantified cost-benefit test for each new mandated threshold, **(ii)** a presumption of "visibility-only" before "dispatch participation", and **(iii)** a formal mechanism to roll back obligations that prove disproportionate. (Nelson et al., 2025, pp. 69, 100).

Recommendation 3: focus CER reforms on market participation and consumer protections

It is good that the Review links CER incentives to being "market ready" (able to participate through aggregators, ready for dynamic network connections), rather than subsidising assets that sit outside the market and later create inequities and constraints. The Review is also right that consumer protections for aggregation services lag behind the technology. (Nelson et al., 2025, pp. 23, 262).

But I would urge caution against the fashionable solution of an overarching "consumer duty" applied broadly to new services. In competitive markets, well-meaning regulatory interventions often increase costs and restrict innovation. I have argued in another context that additional regulatory powers in a competitive retail market may be counterproductive because regulation "inevitably increases costs, slows down innovation and impairs the ability of suppliers to discover and respond to evolving customer preferences." (Littlechild, submission excerpt in corpus).

The question for ministers is: what is the narrowest, most enforceable protection that prevents serious harm without freezing business models? In electricity, the best "consumer protection" is often **effective competition plus clear liability rules**, not broad principles that invite ex post second-guessing and compliance bureaucracy. (Littlechild, 1988; Littlechild, submission excerpt).

Recommendation 4: use rule changes to address algorithmic bidding, battery SoC, and network outages

The Review's instincts are correct: algorithmic bidding and battery-state-of-charge transparency can materially affect market outcomes, and transmission outages can distort spot prices and competition. But the solution should remain targeted: transparency, monitoring, and enforcement against clear anti-competitive conduct, rather than pre-emptive redesign of bidding rules that might suppress legitimate risk management and innovation. (Nelson et al., 2025, pp. 23, 115–119).

A recurring lesson in electricity is that once the rulebook becomes a substitute for judgement and responsibility by market participants, you get a compliance industry and a strategic gaming industry. Ministers should insist on a clear hierarchy: **competition law and market monitoring first; narrow rule changes second; structural redesign last**. (Nelson et al., 2025, pp. 115–119).

Recommendation 5: Reliability Panel to adjust the "form" of market price settings over time

Here I am much more sceptical. The Review proposes that the Reliability Panel provide a long-term outlook on the *form* of market price settings, not merely their level, and links this explicitly to the needs of long-term contracting and the proposed ESEM. (Nelson et al., 2025, pp. 23, 126).

This is precisely how you invite regulatory risk. Investors can tolerate market risk; they struggle with the risk that the rules of reward will be re-written because one technology (say, long-duration storage) is judged to need "sustained high-price periods" while another (say, demand response) is judged to need "sharp, short-duration peaks." Once regulators start "tuning" the shape of scarcity, you are no longer running an energy-only market—you are administratively designing revenue profiles. (Nelson et al., 2025, p. 126).

If ESEM (or any long-term state-backed contracting) requires a stable view of future price caps, that is a warning sign about ESEM's claim to be "market-linked." A better principle is: **keep the price formation mechanism stable**, adjust parameters infrequently and transparently, and allow technologies to compete via contracting and innovation rather than via regulator-designed revenue shapes. (Nelson et al., 2025, pp. 126, 174).

Recommendations 6 & 7: a permanent Market Making Obligation (MMO) and contract co-design

I understand the Review's diagnosis: as coal exits, traditional hedge supply shrinks; OTC innovation may not be accessible to smaller participants; regions like South Australia exhibit declining contract liquidity and rising concerns about concentration and vertical foreclosure. A more liquid, transparent forward curve is "scaffolding" for competition and investability. (Nelson et al., 2025, pp. 14–15).

However, an MMO is a serious intervention. The Review proposes: designate a small set of core products (initially caps and baseload swaps), trigger obligations only when objective liquidity thresholds are breached (starting immediately in South Australia for caps), impose minimum volumes and maximum bid-offer spreads on obliged service providers above a size threshold, and allow voluntary market makers under the same spread rules. (Nelson et al., 2025, pp. 23–24, 149–151).

My critique is not "never do this", but "be honest about the trade". An MMO can help **entry and transparency** if it genuinely ensures that smaller retailers and new entrants can access standard hedges at reasonable spreads. But it can also: **(i)** impose risk costs that incumbents are best placed to bear (raising barriers to entry for smaller generators), **(ii)** create new gaming opportunities around the trigger metrics and the "MMO windows", and **(iii)** move the market further toward an administered forward curve that markets rely on rather than challenge. (Nelson et al., 2025, pp. 149–151).

If ministers proceed, I would insist on four safeguards. First, *tight product discipline*: keep the designated set very small and do not let it become a dumping ground for every new "service" concept. Second, *hard transparency*: publish liquidity metrics, spreads, and performance of obliged market makers so the costs and benefits are visible. Third, *entry orientation*: ensure parcels and contract design support smaller sellers (the Review explicitly flags smaller parcel sizes like 100kW). Fourth, *sunset and review*: the AER should be required to justify continuation with evidence of consumer benefit, not simply continuation by inertia. (Nelson et al., 2025, pp. 155, 23–24).

Recommendation 8: prudential and counterparty risk review

This is sensible. The Review correctly notes that prudential and margining arrangements can duplicate collateral requirements, ignore offsetting exposures, and disproportionately burden smaller, non-vertically integrated participants—exactly the people you want for competitive pressure. It also correctly stresses that reforms must not compromise the financial integrity of the market and may implicate the Corporations Act, Basel framework, and multiple agencies. (Nelson et al., 2025, pp. 166–167).

In my view, if ministers want to do something that is unambiguously pro-competition and pro-customer, this is it: reduce avoidable capital tie-up *without* weakening settlement security. But it must be done with genuine financial-market expertise, not just energy-market instincts. (Nelson et al., 2025, p. 167).

Recommendation 9: extend MT PASA generator availability to five years

More transparency can support contracting and reduce the shock of sudden exits. The Review argues that extending generator availability projections will, in effect, require closure intentions to be signalled within a five-year window and thereby improve outer-year contract liquidity. It also

notes current shortcomings in participant data quality and points to the AER's enforcement powers. (Nelson et al., 2025, pp. 168–169).

I support the direction, but with a warning: forecasts can easily become quasi-plans, and official projections can displace commercial diligence. The right stance is: publish better information, enforce accuracy, but do not let planning products become procurement mandates by stealth. (Nelson et al., 2025, pp. 169, 191).

Recommendation 10: the ESEM—my central concern

The Review proposes that ministers establish an ESEM within the NEL/NER to facilitate investment, explicitly to overcome the tenor gap and to provide long-term signals for bulk energy, shaping and firming services. The illustrative model is: projects contract "in-market" for early years (e.g., years 1–3), then sell standardised derivatives to the ESEM Administrator for later years (e.g., years 4–15), while the Administrator sells equivalent contracts back to the market to create an offsetting position—"integrating" investment support into the market rather than leaving it "adjacent." (Nelson et al., 2025, pp. 174, 179).

The Review is candid that the ESEM Administrator would hold significant financial positions, and stakeholders stress the need for strong governance and for prescription rather than discretion (to avoid turning government into a "public retailer"). The Review proposes a robust risk management framework embedded in legislation, with annual risk management policy updates provided to ministers. (Nelson et al., 2025, pp. 201).

Let me be blunt: once you have created an institution that determines an "anticipated entry trajectory" and procures services against it, you are in the world of central direction—however consultative, however "market-linked." The Review itself presents ESEM as embedding targets and reliability requirements in a procurement trajectory. That is planning with a market interface. (Nelson et al., 2025, pp. 179–191).

In my judgement, ministers should ask two prior questions before embracing ESEM.

First: why are private long-term contracts not being written? The Review's answer is the tenor gap driven by uncertainty (technology, regulation, demand, coal closure policy). But much of that uncertainty is policy-made. If government wants longer-term private contracting, the first order task is to reduce unnecessary regulatory churn and signal a credible, stable framework. Creating ESEM risks treating the symptom (short contracts) while locking in the cause (policy uncertainty) by shifting responsibility to a central mechanism. (Nelson et al., 2025, pp. 15, 174).

Second: what is the limiting failure—coordination, market power, or political constraints? If the failure is market power and vertical foreclosure (a theme the Review raises for South Australia), the remedy is competition policy, entry facilitation, and market design that reduces foreclosure—not necessarily a national warehousing buyer. If the failure is coordination (standard products, liquidity), then MMO/co-design/prudentials may address much of it. If the real failure is political (states will intervene anyway), then ESEM may be an attempt to nationalise and systematise intervention. But then ministers should admit that and put in constitutional-level guardrails, because you have created a durable instrument for intervention. (Nelson et al., 2025, pp. 14–15, 150–151, 174).

If ministers do proceed with ESEM, my advice is to design it as a **strict, minimal backstop**, not as the new centre of investment. The Review's own "evolution not revolution" graphic stresses standardised service contracts, systematic return of contracts to market, and "risks remain in-market." Take those words seriously: no technology-picking, no physical dispatch role, no creeping expansion into "solving" every policy objective through ESEM contracts. (Nelson et al., 2025, p. 179).

Finally, the Review's proposal that the ESEM Administrator facilitate procurement of strategic reserves for high-impact, low-likelihood events, with quantities at jurisdictional discretion, heightens my worry: this is exactly how "backstops" become the norm. Strategic reserves can be sensible if

tightly ring-fenced, but if procured loosely they undermine scarcity pricing and contract incentives in the core market. (Nelson et al., 2025, pp. 26, 173).

Consumer and retail observations: beware well-meaning overreach

The Review's consumer chapter raises sensible issues: network tariffs may conflict with wholesale signals; demand tariffs can confuse customers; DER/CER participation interacts with network pricing; retail price benchmarks (like the DMO) influence hedging behaviour and might need to evolve with new standard products and MMO-driven liquidity. (Nelson et al., 2025, pp. 255–262).

I would add two cautions, grounded in my own experience of retail regulation. First, do not mistake *complexity* for *consumer empowerment*. If tariffs and products become too complex, only sophisticated customers benefit; others cross-subsidise, and political pressure then produces price controls and restrictions that harm competition. Second, resist the instinct to regulate competitive supply as though it were a monopoly network. As I have written elsewhere, regulation in competitive supply can reduce innovation and the ability to discover what customers actually prefer. (Littlechild, submission excerpt; Littlechild, 1988).

At the same time, I do not dismiss consumer protection. I have supported a statutory duty to protect consumers "wherever appropriate, by promoting effective competition," while explicitly having regard to disabled, elderly, rural and low-income customers. The discipline is to use targeted obligations and codes where needed, not broad mandates that turn competitive markets into regulated ones. (Littlechild, corpus excerpt).

Practical advice to the Department: a sequencing and governance strategy

If you want a package that is defensible to ministers and durable over time, I would frame it as follows.

1) Lock in the operational market first. Endorse Recommendation 1 strongly, and treat Recommendations 2–4 as enabling reforms to support price formation and transparency without adding new mandatory short-term markets. This preserves the core NEM "constitution." (Nelson et al., 2025, pp. 69, 100–119).

2) Fix the financial market plumbing before inventing a new investment institution. Do MMO/co-design (carefully), prudentials, and transparency reforms first, and then evaluate whether the residual "tenor gap" truly requires ESEM. Otherwise you risk building ESEM to compensate for forward-market failures that you could have fixed directly. (Nelson et al., 2025, pp. 149–167).

3) Treat Recommendation 5 (market price "form") as a red line for regulatory risk. If ministers want to help long-term contracting, stabilise the framework rather than perpetually redesign scarcity. If ESEM requires redesign of the form of price settings, that is a reason to redesign ESEM, not the spot market. (Nelson et al., 2025, pp. 126, 174).

4) If ESEM proceeds, legislate "prescription over discretion" in a way that is genuinely binding. The Review itself records stakeholders urging that approach. In practice this means: narrow statutory objectives; hard limits on product scope; transparent procurement rules; independent audit; published performance metrics; and a sunset/re-authorisation requirement. Otherwise, ESEM becomes a permanent channel for ad hoc intervention, merely moved inside the NEL/NER. (Nelson et al., 2025, p. 201; p. 191).

5) Be candid with ministers about what ESEM is. External commentary already describes ESEM as a centralised offtake/PPA-like arrangement evolving from CIS and state schemes. If government sells it as "market reform" while industry and analysts experience it as "central

procurement", credibility will suffer and investment uncertainty will increase. (Allens, 2025; Nelson et al., 2025).

If you would like, I can produce a short "briefing note" version of the above for ministers (two pages: what to support, what to amend, what to avoid), but the substance would remain the same: preserve energy-only dispatch, strengthen contracting and entry, and be extremely cautious about institutionalising central direction under the appealing label of "hybrid markets." (Littlechild, 1988; Nelson et al., 2025).
