1 December 2023

Australian Energy Market Operator

By email: NEMReform@aemo.com.au

Dear Sir/ Madam,

Project Energy Connect – Directions Paper

The Australian Financial Markets Association (AFMA) is responding to the Australian Energy Market Operator's (AEMO) consultation on the Project Energy Connect (PEC) Market Integration Directions Paper.

AFMA is the leading industry association promoting efficiency, integrity, and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our role is to provide a forum for industry leadership and to advance the interests of the markets and their respective participants. Our membership is comprised of over 125 of Australia's leading financial market participants, including many of the energy firms who are key participants in the National Electricity Market (NEM) and the Settlement Residue Auctions (SRA).

Key Points

- **The allocation of inter-regional settlement residues should preserve the value of SRA units as inter-regional hedging instruments**
- **There should not be any netting of negative and positive residues**
- **Negative resides should continue to be recovered from Transmission Network Service Providers in the importing region**

SRA units are key instruments that allows participants to hedge inter-regional risk. SRA units allow owners of generation in one region to manage risk in adjoining regions, confident the SRA units will allow them to manage the risk of price separations between the regions. The ability to manage inter-regional risk boosts liquidity in the electricity financial market and gives retailers to access to a larger offering of financial products to manage their spot price risk. AFMA considers that the ability to manage inter-regional risk will only become more important as the NEM becomes more reliant on variable renewable generation; and we are therefore very keen to preserve the value of SRA units as inter-regional hedging products.

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1. Background to the Directions Paper

PEC has been identified by AEMO and a number of governments as a critical infrastructure project to support the energy market transition by giving South Australian based renewable electricity better access to east coast demand while allowing South Australia to rely more heavily on firming capacity in other regions. Inter-regional trading is therefore central to PEC.

PEC is a complex electrical engineering project and AFMA is not in a position to comment on the detail of the proposal to integrate it with the existing grid, but we want to make some observations based on feedback provided to earlier consultations. To AFMA, it appears that in deciding how to integrate PEC, AEMO has faced a choice between the "interconnector approach" that best represent the complex physical reality of the electrical system and the "micro-slice approach" that attempts to imperfectly simplify it. AFMA's observation is that AEMO's preference is for an approach that best represents the electricity system while financial market participants would prefer a less precise approach that, largely, allows PEC to be treated in a similar way to existing interconnectors. Without commenting on the technical merits of either approach, AFMA wishes to state that from the perspective of the financial market simpler, but less precise, approaches are generally preferable and support a greater volume of trading which we consider will better enable PEC to achieve its objectives. AFMA therefore thinks it would be beneficial for AEMO to model the "micro-slice approach" to allow the market to consider its merits relative to the "interconnector approach."

2. Distribution of settlement residues

AFMA understands that the implementation of PEC could lead to a greater volume of negative settlement residues than for existing interconnectors and that AEMO has proposed a number of options to address this including netting of positive and negative residues and changing the allocation of negative residues. AFMA's members support making as few changes as possible to the process for managing negative settlement residues. As pointed out in your paper:

> *Previous regulatory decisions have shifted the allocation of net negative IRSR to the TNSPs and removed netting negative IRSR from positive IRSR, as [netting] was considered to reduce SRA unit firmness without significant benefit or clear distribution of negative residues to customers who benefited from counter-priced flow.*

AFMA's members consider that preserving the firmness of SRA units is critical to ensure they remain effective instruments for managing inter-regional spot price risk. We therefore support retaining the current arrangements of not netting positive and negative residues and allocating negative residues to Transmission Network Service Providers in the importing region. To the extent this results in cashflow issues for Transmission Network Service Providers AFMA considers this should be dealt with through changes to revenue determinations or if necessary the regulatory frameworks for economic regulation.

AFMA Recommendations

i. To preserve the firmness of SRA units:

   a. Positive and negative residues should not be netted

   b. Negative residues should be allocated to Transmission Network Service Providers in the importing region

ii. AEM should model the "micro-slice approach"

AFMA would welcome the opportunity to discuss the impact of PEC on SRAs. Please contact me on 02 9776 7994 or by email at lgamble@afma.com.au.

Yours sincerely

Lindsay Gamble
Policy Director