

4 September 2024

Australian Energy Market Commission



Ref: ERC0386

Submitted online

Project Energy Connect

The Australian Financial Markets Association (AFMA) is responding to the Australian Energy Market Commission's (AEMC) consultation on the Australian Energy Market Operator's (AEMO) proposal to amend the National Electricity Rules regarding inter-regional settlements to accommodate the commissioning of Project Energy Connect (PEC).

AFMA is the leading financial markets 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 membership base is comprised of over 130 of Australia's leading financial market participants, including many energy firms who are key participants in the National Electricity Market (NEM) and the Settlement Residue Auctions (SRA).

Key Points

- **SRA units are critical for managing inter-regional price risk**
- **AEMO's proposed solution is the best option to preserve SRA units as effective risk management instruments**

1. Background to the rule change

AEMO's rule change came about as a result of issues identified during the development and implementation of PEC. 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 delivering the consumer benefits PEC is designed to deliver.

PEC is a complex electrical engineering project which we understand necessarily requires changes to the way SRA units are allocated. AFMA defers to AEMO on the best way to integrate it with the existing grid, but we consider that preserving the value of SRA units is critical to ensuring that PEC is able to deliver the anticipated consumer benefits. AFMA and its members have engaged with AEMO on its work implementing PEC and are confident that the approach proposed by AEMO strikes an appropriate balance between the technical challenges of integrating PEC, preserving the value of SRA units and allocating the cost of negative settlement residues.

2. Role of SRAs

SRA units are key instruments that allow participants to hedge inter-regional risk. SRA units allow generators in one region to manage risk of price separation with adjoining regions, allowing them to

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offer hedge cover in these regions. The ability to manage interregional risk boosts liquidity in the electricity financial market and gives retailers access to a larger offering of financial products to manage their spot price risk, which supports them offering competitive products to consumers.

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 as we consider they are critical to delivering good customer outcomes.

The treatment of negative settlement residues is a key factor in allowing SRA units to be used as inter-regional hedging instruments. To date the policy, which AFMA's members support, has been to allocate negative residues to Transmission Network Service Providers, rather than netting it off against positive residues, as netting would reduce the firmness of SRA units. This approach has been preferred as it preserves the value of SRA units as inter-regional hedging instruments, which delivers greater benefit to customers than the reduction in network charges that netting could deliver.

3. Support for AEMO's proposal

AFMA understands that the implementation of PEC is anticipated to lead to a greater volume of negative settlement residues than for existing interconnectors. AEMO considers that the current arrangements for allocating settlement residues will not be appropriate for PEC and that new arrangements are required.

PEC is an extremely complicated engineering project and AFMA has limited ability to critique AEMO's proposed approach, but we consider that AEMO has undertaken a sound process to develop its implementation approach that has appropriately considered the views of stakeholders, including our members, and reached an appropriate balance that preserves the firmness of SRA units and manages negative residues. We therefore support the approach proposed by AEMO.

AFMA Recommendations

- i. Settlement residues should be allocated in a way that preserves the role of SRA units as inter-regional hedging instruments.
- ii. AFMA supports the implementation of AEMO's proposed approach to the allocation of inter-regional settlements residue.

AFMA would welcome the opportunity to discuss this submission further and would be pleased to provide further information or clarity as required. Please contact me at lgamble@afma.com.au or 02 9776 7994.

Yours sincerely,



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