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Prabpreet Calais
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

23 May 2019

Dear Mr. Calais

RE: Short term forward market, consultation paper

Thank you for the opportunity to provide feedback on the consultation paper for the *Short term forward market* rule change request.

Enel X works with commercial and industrial energy users to develop demand-side flexibility and offer it into wholesale capacity, energy and ancillary services markets worldwide, as well as to network businesses. We have over 50 demand response programs in 12 countries, which involve altering customers' consumption patterns and controlling onsite generation. In the NEM, Enel X participates in the energy and FCAS markets, and has developed reserves for AEMO under the RERT framework, including for the ARENA/AEMO demand response trial.

While the principles underpinning the rule change request have merit, it is not clear what problem AEMO's proposal is trying to address. Before looking to solutions, the AEMC should clearly identify the problem, the magnitude of the problem, and the case for change.

If the problem is a lack of wholesale demand response (as seems to be implied by the suggestion that a short term forward market could partially substitute the need for a demand response mechanism), then a short term forward market will not address it. The AEMC should consider solutions to the lack of wholesale demand response through the three rule change requests on the matter, not through the short term forward market rule change request.

Enel X's responses to specific questions in the consultation paper are set out in the table below. If you have any questions relating to this submission, please feel free to get in contact with me.

Regards

Claire Richards
Manager, Industry Engagement and Regulatory Affairs
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Chapter 5 – Issues for consultation		
Question 3: Current risk management for end users		
3a	How do end users currently manage their short term price risk? Are there any OTC products or financial products such as weather derivatives that are currently used to minimise short term risk?	<p>The paper seems to suggest that the term “end user” refers to market customers – that is, retailers or large customers who buy electricity directly from the spot market.</p> <p>Only a small minority of customers buys electricity from the spot market directly, or chooses to be exposed to the spot price through a retail contract. Such customers are usually large and sophisticated, because it necessarily involves decisions about how to manage the associated risks. However, the vast majority of energy users have no ability or appetite to manage these risks, and so let their retailer take care of it. The result is that most energy consumers are insulated from the spot price and have no incentive to engage with it at all.</p>
3b	Would a STFM assist end users in managing risk? If so how, in particular given the expectation that short term contract prices will approach the spot price closer to the delivery period? What products would be beneficial to be listed?	<p>As above, the phrasing in the paper suggests that the term “end user” is referring to market customers – that is, retailers or large customers who buy electricity directly from the spot market.</p> <p>Enel X is not a market customer, and so we have no view on whether there are currently sufficient opportunities for these parties to manage risk. In theory, a short term forward market should help such parties manage risk because forward prices are likely to be less volatile than real-time prices, while providing more flexibility than the existing suite of longer-term products.</p> <p>However, it is important to establish the nature and magnitude of the problem before implementing solutions. If market customers consider that there are already sufficient opportunities to manage their wholesale market risks, it is not clear that they would see much value in a short term forward market.</p>
3c	Would the introduction of a STFM be beneficial to demand response participants? If so, how? What would be the best way for a demand response participant to maximise benefits from the introduction of a STFM?	<p>The consultation paper suggests that a short term forward market could potentially bring benefits to “demand response participants”. While not explicitly defined, Enel X’s interpretation is that this term is referring to market customers – that is, retailers or large customers who buy electricity directly from the spot market. At the moment, market customers are the only parties able to access the value of wholesale demand response on behalf of the demand side. Wholesale demand response by these parties currently occurs as a result of them unilaterally changing their consumption in response to spot prices (or offering spot pass price through contracts to their customers so that they do this themselves). While this type of demand response is not explicitly visible in market outcomes, it is generally acknowledged that market customers are not delivering wholesale demand response at any significant scale, and that retail customers have the ability and interest to do more. As above, it is not clear to Enel X whether market customers already have sufficient opportunities to manage the risks of wholesale market participation, and thus whether they would see benefit in a short term forward market.</p> <p>A short term forward market would be more likely to present benefits if the term “demand response participants” were to include parties other than market customers. The AEMC is currently considering three rule change requests on wholesale demand response. Two of these propose changes to the NER to give parties other than market customers the ability to offer demand response into the wholesale market. Importantly, these requests propose that demand response be offered into the wholesale market as “negawatts”. As is highlighted in Enel X’s submission</p>

		<p>to the consultation paper on those rule change requests, a “negawatts” approach is the only one that is likely to result in a meaningful increase in the amount of wholesale demand response in the NEM.</p> <p>If a proper wholesale demand response mechanism is introduced, Enel X expects that the short term forward market would present opportunities for demand response service providers to manage the risks associated with their wholesale market participation, and for other parties to buy demand response products to do the same. A wholesale demand response mechanism would allow customers (or aggregators on their behalf) to sell short-term hedges through a short term forward market as a way to lock in value for their responsiveness with much finer granularity than available from quarterly products.</p> <p>However, the ability to do this will greatly depend on the number of participants in the short term forward market, the number and type of products being traded, and the costs of participation. It is not clear that a voluntary market will be sufficiently liquid to enable efficient transactions to occur.</p> <p>Fundamentally, it is important that a short term forward market is not seen as substitutable for a proper wholesale demand response mechanism. The introduction of a short term forward market in itself will not address the current lack of wholesale demand response in the NEM. This problem is better addressed through the three rule change requests on the matter, and the short term forward market (if required at all) should be seen as complementary to it.</p>
3d	What design elements should be considered in considering possible interactions between a STFM and wholesale demand response mechanism?	<p>See above.</p> <p>Greater clarification on the interaction between this rule change request and those considering wholesale demand response would be valuable.</p>
3e	Are there any benefits for introducing a STFM, outside those mentioned in this consultation paper?	<p>It is not clear what problem AEMO’s rule change request is trying to address. A lack of wholesale demand response? A lack of ability for market participants to manage wholesale market risk in the short term? Before pursuing a solution, Enel X recommends that the AEMC conduct further work to clearly define the problem, and the magnitude of the problem. A clear problem definition will deliver a clearer understanding of the solution’s likely benefits.</p>
Question 4: Operation of a STFM		
4a	What are the comparative costs and benefits of AEMO operating a STFM versus a third party? Should this assessment be made by market bodies or a market process (such as an auction)?	<p>Enel X agrees with the AEMC’s conclusion that the design of any short term forward market should maximise the probability of sufficient liquidity and trades in the market while minimising the entry and transaction costs.</p> <p>The consultation paper notes that the ASX already has the systems and processes established to offer short term financial contracts. It would seem sensible to draw on these existing capabilities if a short term forward market were to be established, rather than requiring AEMO or another party to develop them. However, the fact that the ASX has the ability to offer short term electricity derivatives but has not done so to date is telling. As above, Enel X recommends that the AEMC define a clear case for change before considering a regulatory solution.</p>

Question 5: Market participants and liquidity		
5a	Which parties should be allowed to participate in the STFM? What would be the impact on the benefits and costs of an STFM if only market participants (notably, generators and market customers) could participate in the market?	See response to question 3c.
Question 6: Integration of a STFM		
6b	Under an AEMO-operated STFM, is there a specific prudential treatment that would be beneficial to participants? How would this differ to an ASX-operated STFM? How could the choice between prudentials in each market affect the participation in a STFM? Would options that allow leveraging of existing prudentials for use in the STFM increase the prudential risk or default risk that AEMO is managing?	Enel X does not have any specific views on this question, but notes that prudential requirements, by their nature, tend to be more of a barrier to entry for smaller players.
Question 7: Implementation costs		
7b	Would the requirement to attain an AFSL be a significant barrier to operating in the STFM?	Yes. It is generally quite hard to obtain an AFSL.