23 May 2019

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

***National Electricity Amendment (Short Term Forward Market) Rule 2019* - ERC0259**

Energy Queensland Limited (Energy Queensland) appreciates the opportunity to provide a submission to the Australian Energy Market Commission (AEMC) in response to the *National Electricity Amendment (Short Term Forward Market) Rule 2019 consultation paper* (consultation paper). Energy Queensland's responses to the issues raised by the AEMC in the consultation paper are provided in the attached submission.

The purpose of the AEMC's consultation is to obtain stakeholder feedback on a rule change request received from the Australian Energy Market Operator (AEMO) seeking to introduce a market for short term forward contracts for electricity in the national electricity market (NEM). It is intended that this rule change will improve short term spot market price risk management for NEM participants, including intermittent renewable generators, gas fired generators, wholesale customers and demand response participants.

Energy Queensland is supportive of enabling market participants to improve their risk management and promoting increased liquidity in the wholesale electricity market. However, Energy Queensland considers there is already a well-developed financial risk management framework in place to enable participants to manage spot price volatility and provide price stability for retail electricity customers. Consequently, it is recommended that further assessment is undertaken to determine:

- Whether the anticipated benefits, including greater demand side participation and improved system reliability, are likely to be realised and sufficiently material to warrant the costs involved in establishing an AEMO-operated short term forward market;

- How other reforms, such as the wholesale demand response mechanisms rule changes (currently under consultation), the move to five minute settlement and the proposed introduction of a retailer reliability obligation will impact on the design of, or the need for, a short term forward market; and

- Whether it may be worthwhile delaying consideration of the need to implement a short term forward market until after July 2021 to allow informed analysis and testing of the impacts of the fundamental market changes currently underway before determining whether further change and additional financial risk management options are required.

If it is determined by the AEMC that a short term forward market should be progressed, Energy Queensland recommends that it be operated by a specialist financial market operator and that entry and market participation costs are met by those parties who choose to participate.

Should you require additional information or wish to discuss any aspect of Energy Queensland's submission, please do not hesitate to contact me on (07) 3851 6787 or Charmain Martin on (07) 3664 4105.

Yours sincerely

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Energy Queensland

Submission to the Australian Energy Market Commission

National Electricity Amendment (Short Term Forward Market) Rule 2019

Consultation Paper

Energy Queensland Limited

23 May 2019

About Energy Queensland

Energy Queensland Limited (Energy Queensland) is a Queensland Government Owned Corporation that operates a group of businesses providing energy services across Queensland, including:

- Distribution Network Service Providers, Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy);
- a regional service delivery retailer, Ergon Energy Queensland Pty Ltd (Ergon Energy Retail); and
- affiliated contestable business, Yurika Pty Ltd (Yurika), which includes Metering Dynamics Pty Ltd (Metering Dynamics).

Energy Queensland's purpose is to "safely deliver secure, affordable and sustainable energy solutions with our communities and customers" and is focussed on working across its portfolio of activities to deliver customers lower, more predictable power bills while maintaining a safe and reliable supply and a great customer experience.

Our distribution businesses, Energex and Ergon Energy, cover 1.7 million km^2 and supply 37,208 GWh of energy to 2.1 million homes and businesses. Ergon Energy Retail sells electricity to 740,000 customers.

The Energy Queensland Group also includes Yurika, an energy services business creating innovative solutions to deliver customers greater choice and control over their energy needs and access to new solutions and technologies. Metering Dynamics, which is a part of Yurika, is a registered Metering Coordinator, Metering Provider, Metering Data Provider and Embedded Network Manager. Yurika is a key pillar to ensuring that Energy Queensland is able to meet and adapt to changes and developments in the rapidly evolving energy market.

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1 Introduction

On 11 April 2019, the Australian Energy Market Commission (AEMC) published a consultation paper on the *National Electricity Amendment (Short Term Forward Market) Rule 2019* (consultation paper). The purpose of the consultation paper is to seek feedback from stakeholders on a rule change request received from the Australian Energy Market Operator (AEMO).

AEMO's rule change request seeks to introduce a market for trading short term forward contracts for electricity in the national electricity market (NEM). It is intended that the implementation of a short term forward market (STFM) would improve short term spot price risk management for NEM participants, including intermittent renewable generators, gas fired generators, wholesale customers and demand response participants.

The rule change request was submitted by AEMO in response to a *Reliability Frameworks Review* final report recommendation that "a voluntary, contracts-based short term forward market be implemented that would allow participant-to-participant trading of financial contracts closer to real time".[1] This recommendation was part of a package of reforms intended to facilitate increased demand response in the wholesale market in line with Finkel Panel recommendation 6.7.[2]

The AEMC has requested that interested parties make submissions on the issues raised in the consultation paper by 25 May 2019. Energy Queensland's comments are provided in Sections 2 and 3 of this submission.

We are available to discuss this submission or provide further detail regarding the issues raised.

[1] AEMC, *Final Report: Reliability Frameworks Review*, 26 July 2018, p. v.
[2] Finkel et al, *Independent Review into the Future Security of the National Electricity Market – Blueprint for the Future*, June 2017, p. 25.

2 General comments

Energy Queensland is a Queensland-based energy business that delivers electricity to its customers via an integrated business model that enables enhanced flexibility and choice in the energy market. Since its inception on 30 June 2016, Energy Queensland has worked collaboratively to form the largest electricity distribution company in Australia whilst also operating its retail business and establishing an affiliated contestable energy services business. Energy Queensland is focused on effectively leveraging its diverse capabilities across the portfolio to support the prosperity of Queensland communities through the provision of safe, secure, affordable and reliable energy.

Energy Queensland is supportive of enabling market participants to improve their risk management and promoting increased liquidity in the wholesale electricity market. However, Energy Queensland also acknowledges that there is already a well-developed financial risk management framework in place to enable participants to manage spot price volatility and provide price stability for retail electricity customers. While the rule change proposed by AEMO to implement a voluntary, contracts-based STFM may provide more financial risk management options for participants, Energy Queensland considers further detailed analysis is required to determine whether the anticipated benefits, including greater demand side participation and improved system reliability, are likely to be realised and sufficiently material to warrant the costs involved in implementing an AEMO-operated STFM.

Further, Energy Queensland notes that the rule change proposed by AEMO to implement a STFM relates to one of a number of recommendations made by the AEMC in its *Reliability Frameworks Review* final report intended to facilitate increased demand side participation in the wholesale electricity market and thereby lead to improved system reliability. That recommendation formed part of a package of recommendations that includes the introduction of a wholesale demand response mechanism and multiple trading relationships. As such, Energy Queensland considers that the STFM rule change proposal must be considered in conjunction with the other recommended reforms, in particular the wholesale demand response mechanisms rule changes currently under consultation, to identify any potential interactions and overlaps that may impact on the design of, or the need for, a STFM.

Similarly, there are other reforms currently being progressed that will assist in managing exposure to spot price volatility in the wholesale market and promote greater participation of demand response technologies, including the move to five minute settlement (which will commence on 1 July 2021) and the introduction of a retailer reliability obligation (intended to commence on 1 July 2019). It is therefore important that the impacts and anticipated benefits of these reforms on the existing spot and financial market arrangements are also

considered as part of the AEMC's analysis of this rule change proposal. Indeed, in Energy Queensland's view, there may be benefit in delaying consideration of the implementation of a STFM until after July 2021 to allow informed assessment and testing of the impacts of these fundamental changes on the market before determining whether further change and additional financial risk management options are required.

However, if it is determined by the AEMC that a STFM will improve the efficiency of the operation of the NEM and should therefore be progressed, Energy Queensland recommends that:

- Given the STFM will be trading in financial products rather than physical electricity products, it should be operated by a specialist financial market operator, such as the Australian Security Exchange (ASX) or the Financial and Energy Exchange (FEX) Group, rather than AEMO which is responsible for operating Australia's electricity and gas markets and systems, including the physical balancing and security of electricity in the NEM; and

- The costs involved in implementing the STFM should not be onerous, with entry and market participation costs being met by those parties who choose to participate rather than spread across all electricity customers.

Energy Queensland looks forward to participating further in the consultation process on this matter.

3 Detailed comments

CHAPTER 5 – SECTION 5.1 – CURRENT RISK MANAGEMENT

Question 1 – Current risk management for intermittent renewable generators	
(a) How do VRE generators currently manage their spot price risk in the short term? Is there a preference for fully hedging around price and/or volume risk, or an actively managed risk model?	No comment – intermittent renewable energy generators are best placed to answer this question.
(b) Would a STFM assist VRE generators to manage their 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 benefits are there? What products should be listed?	As above.

Question 2 – Current risk management for peaking generation	
a) Would the introduction of a STFM improve the risk management capability of a gas powered generator? If so, how (in particular given the expectation that short term contract prices will approach the spot price closer to the delivery period)? Are there any OTC products that currently exist that serve a similar purpose? What kind of products would be beneficial to be listed?	While the introduction of a STFM may provide a further risk management option, it may not necessarily improve the risk management capability of a gas powered generator as: • many gas powered generators currently already form a hedge for their portfolio, effectively meaning that those generators will only operate when the wholesale electricity price is extremely high or when the price is above the economic cost of the liquefied natural gas netback price; and • other gas powered generators are typically incorporated into a large retail portfolio, with those assets being used to hedge the retailer's own spot price exposure during weather events.
b) Would the introduction of a STFM assist in optimising spark spreads for gas powered generators?	Energy Queensland does not have any comment on this issue.
c) Are there any reasons the STFM would not be used by gas powered generators? Would the differential between expected value of selling a short term product and trading directly on the spot be sufficient to warrant the use of the short term product? How often and for what volume (proportion of a portfolio) would this assist?	The potential use of a STFM by a gas powered generator will be dependent on the costs involved in participating and the generator's willingness to participate (i.e. risk appetite).

Question 3 – Current risk management for end users	
a) How do end users currently manage their short term spot price risk? Are there any OTC products or financial products such as weather derivatives that are currently used to minimise short term risk?	Energy Queensland considers there would be relatively few end use customers currently exposed to spot price risk as retail electricity contracts are an effective mechanism for removing short term spot price risk and providing price certainty to end users. Most large market customers, such as smelters for example, are parties to contracts that require a reduction in consumption during periods of high spot prices. Energy Queensland is not aware of the financial risk appetite of end users with respect to the use of financial products such as weather derivatives to minimise short term risk and recommends that further research is undertaken into the types of short term financial products that would be valued and utilised by end users before progressing this rule change.
b) 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?	In Energy Queensland's view, it is not apparent that there would be a significant demand for end users to utilise a STFM to manage spot price risk as the majority of end use customers have retail electricity contracts in place which effectively shift the spot price risk onto the retailer. Notwithstanding, the spot price risk would likely be built into the forward contract market as the window of the STFM would only be five to eight days.
c) 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?	In considering the potential benefits to demand response participants, it should be borne in mind that demand response aggregators will simply "back to back" demand side response customer contracts with wholesale market participants (usually retailers). There are also risks for an aggregator or a demand side response customer participating in a STFM as contracts transacted on an exchange or through the Trayport platform would be deemed firm by the counterparty to the transaction. As such, there may be financial implications for a demand side response customer or aggregator should that party not be able to fulfil the terms and conditions of the transaction.

d) What design elements should be considered in considering possible interactions between a STFM and wholesale demand response mechanism?	Energy Queensland considers that further analysis is required of the potential interrelationships between the proposed STFM and other recommendations made by the AEMC in its *Reliability Frameworks Review* final report intended to facilitate increased demand side participation in the wholesale electricity market, particularly the proposed implementation of a demand response mechanism (currently under consultation). It is important to determine whether there are any potential interactions and overlaps in these reforms that may impact on the design of, or the need for, a STFM. It is also important that the impacts of the introduction of five minute settlement (which will commence on 1 July 2021) and the retailer reliability obligation (intended to commence on 1 July 2019) on the existing spot and financial market arrangements in the NEM are also tested and considered as part of this analysis.
e) Are there any benefits for introducing a STFM, outside those mentioned in this consultation paper?	Energy Queensland has not identified any additional benefits of introducing a STFM.

CHAPTER 5 – SECTION 5.2 – MARKET DESIGN

Question 4 – Operation of a STFM	
a) 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)?	AEMO is responsible for operating Australia's electricity and gas markets and systems, including the physical trading of electricity in the NEM. The proposed STFM is a financial market that will allow participant-to-participant trading of financial contracts and, as such, should be operated by a specialist financial market operator, such as the ASX or FEX, and be subject to the same legal and regulatory frameworks that govern other financial markets.

	In Energy Queensland's view, a registered exchange is required to operate a market where futures contracts eliminate credit risk and improve market depth and liquidity. Given that some entities may have much more stringent credit requirements than other participants, Energy Queensland considers an over-the-counter contracts market (that would require in-depth negotiation around established credit and trading terms documented under an International Swaps and Derivatives Association Master Agreement) would potentially limit the effectiveness of a STFM.
b) If a third party were to operate the STFM, what level of incentive would be required, and who should pay?	If a registered exchange was responsible for operating the STFM, participants would be required to use licensed clearing brokers to facilitate transactions. As the majority of wholesale electricity market participants already deal on the ASX electricity futures market, the STFM would simply be listed as a new product by the ASX and participants would be charged initial and variation margins.
Question 5 – Market participants and liquidity	
a) 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?	Energy Queensland considers that a STFM, if introduced, should be open to all parties in order to maximise the potential for greater liquidity in the financial electricity market.
b) What products should be offered on the market, additional to those previously suggested? What should be the process for adding/removing products?	In Energy Queensland's view, products should be offered relating to the risk periods of the day as well as the residual hours in both swaps and options (such as caps).

Question 6 – Integration of a STFM	
a) Will there be cost savings to participants by using AEMO's systems as opposed to a third party? If so, what systems should the STFM integrate into?	As noted above, Energy Queensland does not consider that it is appropriate for the physical market operator (AEMO) to be responsible for operating a financial market and that any proposed STFM should be operated by a specialist financial exchange.
b) 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?	Refer above.

CHAPTER 5 – SECTION 5.3 – IMPLEMENTATION COSTS

Question 7 – Implementation costs	
a) What are the likely types of costs (and scale of those costs) incurred from the introduction, and operation of, the STFM proposed by AEMO (and other potential models)?	Under AEMO's proposed model, there are likely to be costs associated with establishing a STFM (including costs of enhancing NEM systems and processes, legal costs and licensing fees) as well as ongoing costs associated with operating a financial market. If the STFM was to be operated by a third party, such as the ASX or FEX, AEMO would not be required to incur these costs. Rather, entry and market participation costs would be met by those parties who choose to participate in the market.
b) Would the requirement to attain an AFSL be a significant barrier to operating in the STFM?	No, the requirement to obtain an Australian Financial Services Licence (AFSL) should not be a barrier to operating in the STFM for existing wholesale market participants as those participants should already be in a position to satisfy the AFSL requirements.
c) If the STFM were to be implemented, what other operational and implementation issues may arise? How much time is required for market bodies and participants to prepare for the introduction of an operational STFM?	Energy Queensland recommends that further consideration of the implementation of a STFM should be delayed until after the introduction of five minute settlement in mid-2021. Given the significant changes to market procedures and systems and the benefits that are expected to flow from the move to five minute settlement, including improvements to price signals, incentives and reduction in volatility, Energy Queensland considers it may be worthwhile waiting until this reform has been finalised and tested before determining whether investment in additional risk management options is required.

d) Is the proposed assessment framework appropriate? Should any criteria be added or removed?	Energy Queensland is supportive of the AEMC's proposed assessment framework for determining whether the STFM rule change proposal will promote the national electricity objective. Energy Queensland considers that further detailed analysis is necessary to establish whether the intended benefits of a STFM, including greater demand side participation, are likely to be realised and sufficiently material to warrant the costs involved in its implementation as well as ensure there is no risk of unintended consequences.