

3 February 2020

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By online submission

Level 22
530 Collins Street
Melbourne VIC 3000

Postal Address:
GPO Box 2008
Melbourne VIC 3001

T 1300 858724
F 03 9609 8080

Dear Mr Pierce

Draft Rule Determination – Short term forward market (ERC0259)

Thank you for the opportunity to provide a submission to the Commission's draft rule determination to not introduce a voluntary short term forward market (STFM).

The Final Report of the Commission's Reliability Frameworks Review indicated that *"there would be benefits to the introduction of a voluntary, contract-based short-term forward market, particularly for demand response"* and recommended that AEMO develop and submit a rule change request¹.

In this context, AEMO is disappointed with the Commission's draft decision. AEMO remains of the view that a STFM can serve the long-term interest of consumers by providing market participants with an additional tool to manage spot price risk. This has the potential to enable increased participation of demand response, improve coordination between gas and electricity trading, and dampen the impact of increasing price volatility. AEMO considers that a STFM would support the transition to a market with more variable renewable energy generation and demand response.

AEMO acknowledges that it is difficult to accurately predict the future usage of a new trading market and cautions against over-reliance on such predictions when making the final determination. Traded volumes may continue to increase over many years, as participants gain confidence and experience with new markets, and as previous contracting and hedging arrangements expire. This difficulty is reflected in the continuing exponential growth of traded volumes on the AEMO-operated gas supply hub (GSH) markets, nearly six years after the Wallumbilla GSH commenced in March 2014. Traded volumes increased at a compound annual growth rate of 44 per cent from 2015 to 2019, and by 67 per cent from 2018 to 2019².

¹ AEMC, *Final Report, Reliability Frameworks Review*, 26 July 2018, available at https://www.aemc.gov.au/sites/default/files/2018-07/Final%20report_0.pdf, accessed 21 January 2020.

² Total GSH traded volumes were 6,434 TJ for calendar year 2015, 16,379 TJ for 2018 and 27,380 TJ for 2019. Data available at <https://aemo.com.au/energy-systems/major-publications/quarterly-energy-dynamics-qed>, accessed 31 January 2020.

AEMO considers that the implementation of a STFM at this time would provide a ‘low-regrets’ addition to the design of the National Electricity Market (NEM). AEMO expects that it could implement a STFM at low cost by using the same Trayport platform that is used for the Gas Supply Hub, as outlined in previous submissions. The STFM could provide a foundation for further evolution of ahead markets, which are being considered in the Energy Security Board (ESB) project on the Post 2025 Market Design for the NEM³ and the advice requested by the COAG Energy Council on Immediate Reliability and Security Measures⁴.

AEMO has reviewed the draft rule determination and considers that several reasons articulated by the Commission warrant reconsideration. The table below lists these reasons and AEMO’s responses.

AEMC reason	AEMO response
<p>A STFM may provide minimal benefit for buyers because the likely STFM clearing price before a high-priced event would be relatively high, reducing the STFM effectiveness.</p>	<p>As with any contract market, the strike price is only high or low relative to eventual price outcomes. If a buyer has protected itself against a market price cap (MPC) event by buying a high price product on the STFM, this is a worthwhile transaction.</p> <p>AEMO agrees that average STFM prices would be expected to converge towards average spot prices over the long term. However, variability of both supply and demand can lead to volatility of spot price outcomes. An STFM can assist buyers by smoothing this volatility.</p> <p>This benefit is demonstrated by comparing prices between the day-ahead Short Term Energy Market (STEM) and Balancing Market in Western Australia’s Wholesale Electricity Market (WEM). For the 18-month period from July 2018 to December 2019, average prices between the two markets differed by less than \$2/MWh. However, the standard deviation of Balancing prices was nearly 50 per cent higher than the standard deviation of STEM prices.⁵</p>

³ More information on this review is available at <http://www.coagenergycouncil.gov.au/publications/post-2025-market-design-issues-paper-%E2%80%93-september-2019>, accessed 21 January 2020.

⁴ The scope of this request is available at <http://www.coagenergycouncil.gov.au/publications/immediate-reliability-and-security-measures>, accessed 21 January 2020.

⁵ WEM price outcomes are available at <http://data.wa.aemo.com.au/#balancing-summary> and <http://data.wa.aemo.com.au/#stem-summary>, accessed 31 January 2020. The period analysed was from 8 AM on 1 July 2018 to 8 AM on 1 January 2020. STEM prices for this period ranged from -\$33.04/MWh to \$176.66/MWh, with an average of \$44.85/MWh and standard deviation of \$20.84/MWh. Balancing prices ranged from -\$1,000/MWh to \$302/MWh, with an average of \$46.59/MWh and standard deviation of \$30.61/MWh.

	<p>A STFM in the NEM may provide greater protection from price volatility, given that the NEM's MPC far exceeds energy price limits in the WEM.</p>
<p>A targeted wholesale demand response mechanism would be more effective at incentivising additional demand response capacity, so there may be little demand for a STFM among demand response participants.</p>	<p>The AEMC's draft Rule for the wholesale demand response (WDR) mechanism⁶ does not include a mechanism for demand response providers to lock in price certainty ahead of the regular spot market process.</p> <p>Evidence from the joint AEMO-ARENA demand response trial⁷ has shown that some demand response providers require more notice to vary their demand than is provided under the regular spot market process. Such providers would likely benefit from the ability to lock in price certainty and reduce the risk associated with their participation in demand response.</p> <p>In this way, AEMO considers that a STFM can complement a targeted WDR mechanism to support participation by the widest range of efficient demand response providers.</p>
<p>There may be little demand for a STFM among gas generators as all open cycle gas turbine (OCGT) capacity is currently owned by participants who can optimise within larger, diversified generation portfolios.</p>	<p>AEMO cautions that point-in-time observations on market structure do not provide sound justification for rule-making decisions.</p> <p>New evidence suggests that ownership of gas peaking generation will diversify in coming years. The Commonwealth Government has announced that it will underwrite two new gas-fired peaking generation projects through its Underwriting New Generation Investment scheme⁸. The proponents for these power stations (APA Group and Quinbrook Infrastructure Partners) do not have larger generation portfolios.</p> <p>Given that the new projects are entering the market through a government underwriting scheme, AEMO considers there may be merit in investigating whether there is a causal link between the existing risk management</p>

⁶ Available at <https://www.aemc.gov.au/rule-changes/wholesale-demand-response-mechanism>, accessed 22 January 2020.

⁷ More information on this trial is available at <https://arena.gov.au/news/aemo-arena-demand-response/>, accessed 22 January 2020.

⁸ Ministerial announcement, *Initial support terms for two new generation projects agreed*, 23 December 2019, <https://minister.environment.gov.au/taylor/news/2019/initial-support-terms-two-new-generation-projects-agreed>, accessed 22 January 2020.

	<p>options and practices and the current market structure, which may further demonstrate a gap that can be filled by a STFM. AEMO notes that the ACCC previously identified barriers to effective hedging in the NEM, particularly for smaller retailers⁹.</p>
<p>The introduction of an AEMO-operated STFM may negatively impact existing financial contract markets.</p>	<p>AEMO considers that it is possible that the availability of short-term contract products could enhance the available options for participants to manage risk within monthly and quarterly contracts, which brings new participants into monthly and quarterly markets.</p> <p>AEMO considers that any negative impact on existing financial contract markets would indicate that a STFM is meeting a genuine need in the market, offering more desirable products.</p> <p>As stated above, AEMO expects that it could implement a STFM at low cost.</p>
<p>Enduring reforms that bring the NEM closer to a two-sided market would be more valuable to support reliability and security.</p>	<p>As stated above, AEMO considers that a STFM could provide a foundation for further evolution of ahead markets, which is being considered in the Energy Security Board (ESB) project on the Post 2025 Market Design for the NEM and the advice requested by the COAG Energy Council on Immediate Reliability and Security Measures.</p>

AEMO would welcome the opportunity to discuss the matters raised in this submission further. Should you have any questions, please contact Kevin Ly, Group Manager Regulation at kevin.ly@aemo.com.au.

Yours sincerely



Peter Geers
 Chief Strategy and Markets Officer

⁹ ACCC, *Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry – Final Report*, June 2018, Chapter 5, available at <https://www.accc.gov.au/publications/restoring-electricity-affordability-australias-competitive-advantage>, accessed 22 January 2020.