18 January 2023

To: Australian Energy Market Operator

By email: StakeholderRelations@aemo.com.au

Haast Energy Trading submission regarding Project Energy Connect Implementation Paper

Haast Energy Trading (**Haast**) welcomes the opportunity to submit on the Australian Energy Operator's (**AEMO**) Project Energy Connect Implementation Paper (**PECIP**).

Haast is a financial intermediary and trader in the National Electricity Market (**NEM**), including in settlement residue auctions (**SRAs**). We repackage risk for other market participants such as independent retailers, and provide liquidity to markets by taking proprietary positions when we perceive products to be mispriced on an absolute or relative basis.

We believe SRAs contribute significant liquidity to listed futures and OTC markets in the NEM by providing wide access to a pool of risk that can be repackaged into hedges which generators and consumers demand. We encourage AEMO to consider the wider impact on the hedge market as it considers changes to SRAs.

Risks to hedge market liquidity

SRAs provide useful opportunities for repackaging as long as the units sold are meaningfully correlated with other products which consumers and generators want to trade. If the market design produces units which have little or no correlation with absolute or relative energy prices then the positive impact SRAs have on wider hedge market liquidity will fade.

AEMOs analysis in the PECIP concludes that in regions impacted by network loops with Negative Settlement Residue (**NSR**) clamping removed, it should still be possible to construct pairs of units which always have positive settlement residue. We generally agree with this view but highlight that simplifications due to zonal pricing, and the exercise of market power may lead to outcomes which are counter to this.

In particular the removal of NSR clamping may lead to a significant change in participant bidding strategies and behaviour. The plant in and around the former Snowy region appears to have significant scope to tune residue outcomes based on their interests, and the removal NSR clamping may increase the opportunity and incentive for this to happen.

Consideration should be given to how the market power risks could be mitigated with one possible tool being a trading conduct regime.

Collateral and prudential reform

If AEMO proceeds with option 1(b) it will have significant implications on the risk profile of SRA units. A redesign of the collateral and prudential requirements for participating in SRAs should recognise that holding certain pairs of SRA units significantly reduces or eliminates the risk of NSR accruing. Implementation of a conservative collateral and prudential regime that didn't offer appropriate netting may severely curtail access to SRAs and have a negative impact on hedge market liquidity.

Introducing new prudential and collateral obligations may be complex and decrease participation in auctions. For this reason, choosing an option which avoids prudential and collateral reform may be preferable.

Answers to consultation questions

1. Do stakeholder have any questions on the planned activities associated with the market integration of PEC?

   More detail on the timeline for implementation would be welcome, including on when a decision may be made regarding changing the NER, and what options SRA unit holders will have if the units they hold are impacted.

2. Which option best meets the guiding principles identified in Section 4.2.5?

   In the long run we support option 4. We believe a market design change to LMP and FTRs will send more effective price signals and lead to better outcomes for consumers and industry players.

   Assuming that option 4 is not being seriously considered before PEC is due to be delivered, our preferred solution depends on the details of the accompanying changes. We would support 1(b) if accompanied by a trading conduct regime and an efficient prudential and collateral regime.

   Without confidence that these accompanying measures could be delivered 1(c) may be preferred with Traders initially incurring losses up to the purchase price of the SRA unit, and the TNSP incurring losses beyond that. This arrangement may require no prudential and collateral reforms.

3. Are there further material advantages or disadvantages that have not been listed for any of the options outlined in this section?

   As we have discussed in our cover letter we believe AEMO should be mindful that:

      a. Risk repackaging from the SRA market adds significantly to hedge market liquidity.
      b. Removing NSR clamping may increase the opportunity for the exercise of market power.

4. If NSR were to accrue to a Trader, what would be the effect of introducing prudential arrangements for Traders and how would this impact on participation in SRA?

   Introducing a prudential regime will increase barriers to entry and reduce participation in SRAs. This will have flow on effects to hedge market liquidity via decreased repackaging as outlined above.

5. Do stakeholders have any other suggestions or alternative approaches to the management of NSR that will occur with the implementation of PEC?

   We believe an effective trading conduct regime would reduce the risk of market outcomes being dominated by the exercise of market power if 1(b) is chosen.

   We believe a pragmatic and low cost approach may be 1(c) with the Trader only exposed to losses up to the SRA unit purchase price. As mentioned above this may avoid the need for prudential and collateral reform while still allowing efficient NSR market solutions and avoids TNSP exposure except in relatively extreme outcomes.

6. Should any change to NSR management is applied to loop flows only, or more broadly to all interconnector flows? While it may be possible to designate and define 'loop flow' conditions, there is a question of whether the broader principles adopted are appropriate for all flows.

   We don't have a strong view on this.

7. What factors should be considered with the timing and approach of the auction of PEC SRA units?

   PEC SRA units should be offered based on the best available information of when the project will be delivered and contributing to settlement residues. Because other SRA units will be significantly impacted by the commissioning, and buying bundles of links may be an important risk management tool, a conservative approach to offering the units may be disruptive.

8. What consideration needs to be given as to the treatment of units already auctioned should changes associated with PEC go ahead?

   If Traders are asked to accept exposure to risks which they have little ability to manage they are likely to discounts bids heavily for accepting these risks. We believe AEMO is likely to maximise net auction revenue if it provides reasonable backstop arrangements to Traders if changes associated with incorporating PEC beyond normal market risks lead to the impairment of SRA units.

9. How should changes to NSR management be considered and implemented in respect of the ESB's concurrent reform activity for congestion management?

   As mentioned above we believe a market design of LMP plus FTRs is the gold standard for efficient outcomes and consumer benefit. We support a move towards this model in the medium to long term.

Sincerely,

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