

26 May 2023

Anna Collyer
Chair
Energy Security Board



Submitted by email: info@esb.org.au

Dear Ms Collyer,

Transmission Access Reform – Consultation Paper

The Australian Financial Markets Association (AFMA) is responding to the Energy Security Board's (ESB) Transmission Access Reform – Consultation Paper.

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets. AFMA has more than 125 members reflecting a broad range of participants in Australia's financial markets, including energy companies who operate the majority of scheduled and semi-scheduled generation in the NEM and are key participants in Australia's energy markets.

Key Points

- **AFMA supports:**
 - **implementation of the enhanced information reforms**
 - **ceasing work on the CMM**
- **The CRM should be developed as a genuinely optional ancillary enhancement to the NEM**
- **The ESB should work with financial market participants to ensure their cost benefit analysis appropriately reflects changes to participants' hedging costs**

AFMA notes the Energy and Climate Change Ministerial Council's (ECMC) recent decision to disband the ESB from 1 July 2023. AFMA also supports the decisions made at ECMC's February meeting to implement the enhanced information reforms to provide east-coast market participants with better information on the optimal location for new generation and storage and to cease the ESB's work on the Congestion Management Model (CMM). AFMA supports ECMC taking a more direct role in policy development and encourages them to take the opportunity to holistically consider their approach to energy and climate policy to ensure that they are able to achieve their objectives at the least cost. Particularly we want to draw ECMC's attention to the limited operational benefits and substantial costs of changes to AEMO's dispatch arrangements compared to the substantial gains to be made by ensuring efficient investment in new generation, storage and transmission capacity.

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AFMA's main focus in responding to this consultation is to ensure that the design of the physical market continues to support efficient risk management through the financial market. We wish to ensure that any reforms do not compromise the critical role of the Regional Reference Price (RRP) as the key pricing indicator in the NEM.

Our submission focuses on areas AFMA considers the CRM and priority access arrangements could be improved to maximise their benefits while minimising the cost to the market and encourages ECMC to ensure the costs and benefits of any reforms are fully understood.

1. Role of the financial market

AFMA's focus is on ensuring that the design of the NEM remains suitable to support a robust financial market that participants can use to manage their electricity market price risk. As we have indicated in a previous submission,¹ while there is undoubtedly scope to improve and simplify the NEM, the most successful feature of the current design is the way in which it concentrates the risks faced by market participants into a single spot price for each region, the Regional Reference Price (RRP). An advantage of the current regional design is that it brings together a large number of buyers and sellers who are all incentivised to manage their exposure to the RRP which creates liquidity. The combination of an easily understood reference price and a large number of market participants exposed to price movements, has provided a solid foundation for the development of liquid financial markets based on the RRP. AFMA wants to acknowledge that the RRP is not the most efficient arrangement for spot dispatch. Market participants are aware of this but are comfortable with the compromises of the current market design as it facilitates more efficient contract market outcomes than any of the proposed alternative arrangements, which is ultimately more important for participants in the market than the efficiency of 5 minute dispatch.

AFMA has therefore been very concerned about any proposals that could reduce the importance of the RRP as a price signal or reduce liquidity in the market. We have previously expressed strong opposition to the AEMC's Coordination of Generation and Transmission Investment proposal² and the ESB's CMM;³ on the basis that they would introduce a further source of risk, basis risk, which is the movement in the difference between the RRP and the local prices that would be faced by participants. We anticipate that these approaches would reduce the effectiveness of the RRP as a pricing signal and reduce liquidity. This could result in a reduction in participants ability to manage their risk as participants risk would be tied to their local price rather than the RRP. Additionally, introducing a new source of risk leads to further complication of the market.

In AFMA's view the CRM can potentially be superior to either of these options as it could allow voluntary transactions to optimise participants dispatch behind constraints without undermining the primacy of the RRP as the key risk management signal. To achieve this the CRM should be developed as a voluntary ancillary mechanism that complements the NEM without further complicating the market design.

¹ [https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-\(3\)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-(3)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf)

² https://afma.com.au/Site/media/Media/Documents/2019/Policy/R38-19_AEMC_COGATI_Proposed_Access_Model_-_Discussion_Paper.pdf?ext=.pdf

³ <https://afma.com.au/getattachment/c98c2368-b679-41bf-89f0-6f6b49651a0f/R27-22-ESB-Transmission-Access-Reform.pdf?lang=en-AU&ext=.pdf>

AFMA Recommendations

- i. The CRM should be developed as a genuinely optional ancillary enhancement to the NEM.

2. Thorough cost benefit analysis

The cost benefit analysis the ESB provided to ECMC identified that implementing the CRM and priority access will involve substantial costs for both AEMO and participants. The cost benefit analysis identifies the direct costs for AEMO and market participants as ~\$260m to 2050 and that between \$77m and \$156m will be incurred as upfront costs.⁴ These are obviously very substantial upfront costs for the market, particularly in the current context of high energy prices contributing to increases in the cost of living. AFMA's members are therefore very keen for the promised benefits to be rigorously tested prior to any decision to implement these changes to avoid unnecessary costs being passed onto consumers.

The cost benefit analysis only considers the IT and legal costs of implementing the CRM. As pointed out in our previous submissions AFMA considers that the ESB's analysis has not given adequate weight to the impact of their proposals on the financial markets.⁵ As raised in our previous submissions our members are concerned that substantial changes to NEM dispatch may have an adverse effect on their ability to hedge their electricity market price risks. Changes to hedging costs have not been included in the ESB's cost benefit analysis but we anticipate would have a substantial bearing on the costs and benefits of the reforms, possibly of a similar order to the changes in capital expenditure over the investment timeframe that the cost benefit analysis has identified. AFMA and its members are willing to work with ECMC and its consultants to ensure these costs are reflected adequately.

AFMA's members also wish to point out that the cost benefit analysis identifies that over 92% of the implementation cost relates to the implementation of the CRM. The CRM has been consistently described as intended to address congestion in the operational timeframe, but according to the cost benefit analysis only \$0.49b of the expected benefit of implementing both the CRM and priority access are expected to come from operational benefits, while the remaining \$3.8b of benefit is expected to come from more efficient locational decisions made in the investment timeframe. This analysis suggests that the majority of the benefits will be achieved in the investment timeframe while the potential benefits of further optimisation of the NEM dispatch process are quite limited compared to the already identified direct implementation costs, which as noted above do not assess the impact on the hedging market. The ESB did not model the benefits of priority access without the CRM but the analysis of implementing congestion fees alone indicates that for modest AEMO implementation costs it would deliver the same \$3.8b benefit, from better locational decisions, as the CRM and priority access. To AFMA this suggests that policy thinking might be more usefully directed to reasonably low-cost mechanisms to address locational decision making rather than the expensive and higher risk options involving altering NEM dispatch arrangements.

⁴ See Executive Summary and Part 5.5 of the [ESB's Transmission access reform Cost benefit analysis](#)

⁵ [https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-\(3\)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-(3)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf)

AFMA Recommendations

- ii. ECMC should work with financial market participants to ensure its cost benefit analysis appropriately reflects changes to participants' hedging costs.
- iii. ECMC should consider if policies aimed at the investment timeframe would achieve their objectives at lower cost and risk to the market than ones directed at the operational timeframe.

3. Congestion relief market

For the CRM to achieve the operational benefits the ESB has identified without causing unnecessary disruption to the market and cost to participants, it should be developed as a purely voluntary ancillary market that participants may choose to enter and leave as they see fit. We are concerned that while the CRM is described as an opt-in market there are elements of it that may mean that opting-out is not a viable choice. Additionally, AFMA has some concerns with some of the ESB's proposals concerning bidding in the CRM.

3.1. A truly voluntary market

To be a truly voluntary market AFMA considers that; participants must be free to opt-in and out of the CRM and it must have no impact on dispatch, energy or FCAS payments for participants who opt-out. Several features of the model proposed in the Consultation Paper raise concerns that the CRM will not be truly voluntary.

3.1.1. Hotel California

A comment in section 4.3.2 of the paper that "Once opted in [to the CRM] they cannot opt-out again" is concerning to us. On its face this is an outrageous statement for an instrument that is supposed to be voluntary, but in context it is clear that it is driven by a pre-mature (and poor) AEMO system design decisions to simplify AEMO's processes by requiring everyone who has opted in to the CRM to continue to put in two sets of bids. Given the sensitivity about the CRM being a voluntary market, AFMA suggests this is a very poor design choice and that AEMO's system preferences should not drive policy decisions, particularly as the cost benefit analysis anticipates substantial funding for AEMO system work. Additionally, as discussed below in section 3.2.1 we think further work needs to be done on the bidding arrangement and that given the importance of the bidding interfaces to participants we think this level of detailed design should be done in close cooperation with participant (and their IT vendors) once the policy positions have been settled. We note that the design of AEMO's systems is also relevant for priority access, which we discuss below in section 4.6.

3.1.2. No impact on dispatch or pricing

AFMA's members have been consistent that the CRM should be developed in a way that does not interfere with dispatch or pricing outcomes for participants who choose not to participate. The Consultation Paper has made an important step by recognising that solely energy outcomes should determine the RRP, but we are concerned by the proposals in section 4.2.5 of the Consultation Paper relating to FCAS. AFMA's view is that all design decisions should be made to minimise the impact of

the CRM on the existing energy market, and we point the ESB to the proposal we made in section 3.1 of our previous submission to fully separate the energy and CRM markets.⁶

The potential impact of these reforms on the dispatch of opt-out participants is more problematic. By itself the CRM appears to have limited impact on the dispatch of opt-out participants but the ESB has presented it as a package with the priority access framework, which is intended to have an impact on dispatch outcomes. While not stated in the paper from their public statements the ESB appears to acknowledge that the current priority access proposal will result in less efficient dispatch than the current arrangements unless participants also use the CRM to compensate.⁷ This is concerning to us as it appears to indicate that participants will effectively be required to participate in the CRM to gain the same level of dispatch that they enjoy under the current market arrangements. The ESB has noted that it anticipates NEM and CRM prices to converge over time, we are concerned that in the long run this could mean that effectively all market participants will face local marginal prices. AFMA understands that it is not the intent of ECMC to introduce local marginal pricing and we are therefore concerned that the CRM should not be developed in a way that results in this.

3.2. Bidding in CRM

3.2.1. Submitting bids

Section 4.2.4 of the Consultation Paper raises valid questions about how participants will bid in the CRM. AFMA agrees that, as in the energy market, participants in the CRM should be able to limit their exposure to the CRM by specifying the prices and volumes that they are able to offer into the CRM. From the paper it appears that the ESB has assumed that CRM bids will take the same form as energy bids (10 volume and price steps) but as raised in the paper this may not be the most appropriate model for the CRM. AFMA suggest that the CRM might be better served with separate bid and offer stacks (such as used for the Gas Supply Hub) that would allow participants to indicate their desire to increase or decrease output in response to the CRM.

AFMA recommends that the ESB should make a policy decision that CRM bidding should allow participants to control the volumes and prices that they offer in the CRM and that the system design to implement this should be made in consultation with market participants after policy positions have been settled.

3.2.2. Short run marginal cost bidding

Section 4.2.1 of the Consultation Paper indicates that the ESB and AER are exploring the potential for market manipulation in the CRM. As discussed in our previous submissions,⁸ AFMA wants to caution that bidding below Short Run Marginal Cost (SRMC) is not necessarily inefficient. AFMA considers that there are a number of legitimate operational and commercial reasons why a participant would be willing to be dispatched at a spot price that is lower than their SRMC, including the impact of the participant's positions in the financial market. AFMA's view is that it is the role of the market to

⁶ [https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-\(3\)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-(3)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf)

⁷ ESB AFMA member briefing 17 May 2023

⁸ [https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-\(3\)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf](https://afma.com.au/getattachment/Policy/Submissions/2022/R01-22-AGD-Privacy-Review-Consultation-(3)/R85-22-ESB-Transmission-access-directions-paper.pdf?lang=en-AU&ext=.pdf)

determine efficient dispatch based on the commercial decisions of the participants, including decisions to run below SRMC, and that there should be no restrictions on participants flexibility to run their units as they see fit.

We therefore think the proposed approach of post implementation monitoring to determine if there are any unexpected outcomes is appropriate.

AFMA Recommendations

- iv. The CRM should to allow participants to enter and leave it as they see fit.
- v. The CRM should be designed to minimise the impact on participants who choose not to participate in it.
- vi. CRM participants should be able to control the volumes and prices they offer to the CRM through their bids.
- vii. No additional compliance mechanisms are required at this stage.
- viii. AEMO system design decisions should be made in consultation with market participants after policy positions have been settled.

4. Priority access

AFMA's members have differing views on the overall merits of priority access including a significant number who do not support it, but there are a number of enhancements to the design that we have obtained consensus on.

4.1. Auctions not preferred

The Consultation paper includes a number of options for allocating priority access including through auctions. Our members do not support auctioning priority rights as they consider this would, in substance, be very similar to the financial transmission rights proposals that have been made and rejected in the past. While our members differ on the mechanism that should be used to allocate priority access, they agree that it should not be based on participants willingness to pay for access as this effectively results in a financial transmission rights scheme.

4.2. Life of plant allocation

The Consultation Paper proposes a number of options about the duration of priority access rights. AFMA's member's view is that to serve as an effective signal in the investment timeframe the priority rights need to apply for the lifetime of the project. AFMA therefore recommends that priority access rights should be assigned for the life of an asset.

4.3. Risk for new participants

While the ESB has proposed several ways priority access could be allocated most favour incumbents over new entrants. While we appreciate that the aim of priority access is to incentivise new entrants to connect in less congested areas of the grid our members are concerned that the approach is likely to shift much of the risk of congestion onto new entrants. AFMA is concerned that this could unintentionally disincentivise new investment and we think the ESB should carefully consider the impact of any reform on new entrants. We particularly wish to point out that it is important not to

disincentivise new investment given a number of state governments have quite aggressive targets for new generation capacity.

4.4. Capacity squatting

The point in a project or REZs development cycle that its access rights are determined is a critical design consideration for the ESB. To facilitate private investment this will need to be early enough in the development process that it can form part of a developer's funding proposal but granting priority access too early may result in high priority slots being granted to projects that are not developed for many years and which may ultimately connect into areas of the grid that are more congested than when they were first proposed. Our members are particularly concerned about the approach to assigning priority to REZs as their development is driven by jurisdictional policy decisions and it is possible that governments may propose a number of REZs that ultimately do not proceed. Our members are concerned that the priority access framework may incentivise behaviour designed to secure higher access rights for projects that may not proceed for some time, this is undesirable as it may inhibit investment by other developers as the earlier projects effectively quarantine areas of the grid.

AFMA recommends that the ESB carefully consider when in the development process priority access is granted and consider a use it or lose it arrangements where priority can be revoked if a project is not commissioned within a reasonable period. It may also be worth considering an option to reduce the capacity assigned to a REZ if it is not as successful as anticipated.

4.5. Less efficient dispatch

The ESB has indicated that without high levels of participation in the CRM the proposed priority access model is likely to result in less efficient dispatch outcomes than the current arrangements. AFMA has reservations about this approach as the CRM has always been presented as a voluntary mechanism to deal with current operational constraints rather than as a necessary adjunct to priority access. We do not want participants to be forced to participate in the CRM and are concerned that priority access will result in less efficient dispatch if participants do not participate in the CRM to the extent the ESB anticipates. AFMA suggests the ESB should consider developing priority access in a way that minimises inefficient dispatch, even without high levels of participation in the CRM.

4.6. Implementing priority access

The Directions Paper identifies that NEMDE will need a way to identify bids from units with priority access rights. The paper proposes that this could be done by allowing units with higher priority rights to bid at lower market floors than other participants. While AFMA appreciates that NEMDE will need a mechanism to identify units with higher priority we do not think that changing the way that participants bid is an appropriate way to do this both as it increase the complexity of bidding for participants and as it raises concerns that the different floor prices will be used to set market prices. As we have said above in section 3.1.1 we think that AEMO systems design decisions should be made in consultation with market participants after the policy decisions have been made.

AFMA Recommendations

- ix. Priority access rights should not be assigned by auction.
- x. Priority access rights should be allocated for the life of the plant.
- xi. The ESB should consider the appropriate allocation of constraint risk between new entrants and incumbents to ensure it does not disincentivise new investment.
- xii. There should be mechanisms to ensure that projects that are not developed cannot prevent future projects from accessing high priority slots.
- xiii. Priority access should be designed to minimise inefficient dispatch outcomes, without needing to rely on high levels of participation in the CRM.
- xiv. AEMO system design decisions for priority access should be made in consultation with market participants after policy decision have been made.

AFMA would welcome the opportunity to discuss our views on the Consultation paper. Please contact me on 02 9776 7994 or by email at lgamble@afma.com.au.

Yours sincerely



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