Westpac

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Australian Energy Market Commission,
Level 6, 201 Elizabeth Street,
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RE: Project Number EPR0039 – OFA request for comment.

About Westpac

Westpac is a major supporter of Australia's electricity sector and market participants. Westpac supports its customers not only as a credit provider to junior retailers and wholesale electricity providers, but also through the provision of a broader range of products and services.

Key amongst these additional products and services is Westpac's role as the largest and oldest financial intermediary in the wholesale electricity market. Westpac is a key market maker and liquidity provider in the SFE and OTC markets – a service which direct feedback clearly indicates is highly valued by our direct customer base and other market participants to enable them to manage the price risks associated with their core business.

The capacity to provide this service effectively is inextricably linked to the existence of an economically efficient and transparent spot market. That is, a market in which the spot price outcomes reflect the real balance of supply and demand as accurately as possible. This a core pillar of all efficient markets for which Westpac will always advocate.

In this context, Westpac welcomes the opportunity to comment on the Optional Firm Access (OFA) framework. In general, we support the framework. We consider that OFA reform will increase market efficiency, both in the short term and over the investment planning horizon.

General Comments

In our role as a liquidity provider for market participants, Westpac transacts a significant percentage of the SFE and OTC market volume and uses the existing SRA interregional product to partially hedge the risks resulting from our price-making activities. The proposed Firm Interconnector Rights (FIRs) would be a superior hedging product to SRAs, allowing us to more competitively price various interregional risk products for our market participant customer base. The proposed changes to the auction format, allowing secondary sale of FIRs through the quarterly auction process is also a positive reform that would add to efficient market operation.

In order for Westpac to effectively provide the liquidity, risk reduction and credit services to the electricity market that it does, it is essential that the spot market is operated in a highly transparent and economically efficient manner. A highly attractive feature of OFA is the removal of incentives for a generator to bid out of merit order in the presence of local transmission constraints.

Comments on Objections Raised

OFA is designed to address congestion, and congestion is no longer a major problem in the NEM.

Congestion issues have improved in recent times, particularly after the central Queensland network upgrades were completed. However, despite this improvement, some market participants in pivotal locations can still find themselves with the potential to influence interconnector flows in the right circumstances. This is not an irregular occurrence with several instances already in 2015.

Congestion can often reoccur with little or no notice. For example, on Sunday the 8th of February 2015, 2 dispatch spikes were caused in South Australia by invocation of a constraint with less than 10 minutes warning.

On the 11th of Feb 2015, a significant QLD constraint was in place over the morning, causing the balance of quarter QLD contract to move several $/MWh in response. The constraint was only introduced the previous afternoon. As it eventuated, the constraint was cancelled halfway through the day because the line outage wasn't actually necessary to achieve the desired works. There were no spikes in the QLD spot market. This example demonstrates that congestion drives risk premiums, even when no volatility actually occurs in the spot price. Additionally, greater consideration by TNSPs of the full implications for the market of their operational decisions would serve to reduce occurrences of undesirable temporary market power.

In general, we suggest that the reduction of constraint-driven volatility does not mean that congestion problems are solved. Hedge contracts logically include a risk premium for the possibility of temporary market power driven by constraints. A reduction of potential market power events would therefore naturally result in a reduction of the risk premium.

Finally, the OFA reform is intended to underpin the next few decades of investment in the NEM. It is a simplification to only cite the recent short term low congestion period when it is entirely possible that significant congestion will re-emerge over investment-length timeframes.

Stronger locational signals are unnecessary. Other factors are more determinative such as proximity to fuel and availability of water. In addition marginal loss factors and constraints already send locational signals.

Respondents have argued in their submissions that locational signals for transmission investment are irrelevant as fuel and water availability are far more important. However, if the future of generation investment in the NEM is renewable generation, then this argument does not hold. Transmission location incentives will influence the optimal location for wind and solar farms.

The AEMO ESOO forecasts show that new thermal generation, requiring fuel or cooling water, are unlikely to be needed in any region of the NEM over the next decade.

On the other hand, it is likely that significant quantities of renewable generation will be built to satisfy the RET or other possible regulatory schemes.

The wind and solar resources required by renewables are more widely distributed over eastern Australia than coal and gas resources. Wind and solar farms also do not require access to cooling water. Hence they have greater flexibility in location and can co-optimise the cost of transmission upgrades and the available resource quality, resulting in greater total investment efficiency.

The current market is over-supplied and load growth is uncertain. No new generation is likely, therefore there is no optimisation of investment problem, making OFA unnecessary.

As above, we disagree that new generation is unlikely. Under existing policy settings, significant new build of wind is expected. Policy settings are harder to forecast than demand, although we note there remains a chance that policy support of renewables may increase as well as decrease.

Consultation Items

If the problems are no longer relevant, whether there are circumstances in which stakeholders could envision any or all of these problems becoming relevant at some time in the future? If not, why not?

We agree that the problems addressed by OFA are less significant in the short term. However, we foresee that these issues could easily re-emerge by the time OFA is implemented. A time of slow change is a preferable time to consider long dated reforms.

The OFA reforms appear that they will take at least three years to implement. Demonstrating the capacity of the market to change, within the last three years;

- Forecast electricity demand is 20-25% lower.

- Carbon pricing has been introduced and repealed.
- Gas is now exported from the east coast.
- Playford, Collinsville, Wallerawang, Tamar Valley, Redbank, Energy Brix and Swanbank E have closed or been withdrawn for a majority of the time.
- Residential retail electricity prices have increased ~20%.
- The price of residential solar has dropped by ~55%
- There have been three prime ministers and four leadership spills.
- State government leadership has changed in 4 out of the 5 NEM states.

In light of the significant change possible within three years, we consider it imprudent to assume the problems OFA is designed to solve will never reoccur.

Conclusion

Westpac supports the Optional Firm Access reforms in general. We consider the current low congestion market environment to be temporary and likely to change over the timescale of OFA implementation.

The Optional Firm Access proposal would be an improvement to NEM design that would increase the efficient and transparent operation of the wholesale electricity market. Reducing unexpected price outcomes would lower volatility, allowing more efficient hedge pricing and interregional transmission capacity expansion.

Feel free to contact us for further information.

Yours Sincerely,

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