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Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Submitted by email to aemc@aemc.gov.au

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**National Electricity Amendment (Secondary trading of settlement residue distribution units)
Rule 2017**

Snowy Hydro Limited welcomes the opportunity to comment on matters raised in the Draft Rule Determination from the Australian Energy Market Commission (the Commission) on the National Electricity Amendment (Secondary trading of Settlement Residue Distribution Units (SRDU)) Rule 2017.

Snowy Hydro Limited is a producer, supplier, trader and retailer of energy in the National Electricity Market (NEM) and a leading provider of risk management financial hedge contracts.

Snowy Hydro does not support the Commission's decision to make a draft rule change. We believe the current settlements residue auction (SRA) process operates effectively and allows secondary SRDU to be traded amongst counterparties. The rule change is not required because there is no market failure with regards to the operation of the SRA market. The primary auction remains fit for purpose with the secondary SRA units already being traded through secondary markets.

The Draft Determination does not provide a clear identification of benefits from the Australian Energy Market Operator (AEMO) secondary trading process while identifying that market participants could be left with a large implementation bill. Snowy Hydro therefore does not consider the need for an AEMO facilitated SRDU secondary trading platform.

Although Snowy Hydro oppose a facilitated secondary trading process run by AEMO, we prefer the Commission's more preferable rule. That is, we agree with the Commission assessment that¹:

Transmission Network Service Provider (TNSP)'s, and by extension their customers, are the appropriate party to bear the risk associated with primary units as they are the beneficiary of the auction proceeds of those primary units. By extension, the benefits of the secondary market are received by the secondary buyers and sellers (and more broadly by consumers) and therefore, these secondary buyers and sellers (and therefore consumers) should bear the risks that arise in the secondary market.

¹ AEMC, Secondary trading of settlement residue distribution units - Draft Determination, page ii

This would mean that:

- AEMO would be required to pay the relevant auction proceeds associated with the primary auction to the TNSP prior to paying out any auction proceeds to any secondary seller; and
- The Rule would prohibit the auction rules from placing additional risks related to secondary trading on AEMO and TNSPs.

No Market Failure

Although the Commission highlights that there may be a lack of liquidity, market inefficiency, higher credit and settlement risk, there is no clear indication of a market failure. The overwhelming feedback from submissions to date is that the current SRA process remains fit for purpose. We note that there already exists a mechanism which allows secondary SRDU to be traded amongst counterparts and do not see the need for a facilitated SRDU secondary trading platform.

High risk of speculation

Snowy Hydro is concerned that with the uncertainty that currently resides in the NEM, due to a changing generation plant mix and increase intermittent generation, the risk of default in the NEM is likely to be on the rise. We believe the current SRA process operates effectively and already allows secondary SRDU to be traded amongst counterparties. Under these current secondary trading mechanism the risk of default resides with the secondary seller.

Under Westpac's proposal, the Commission notes that a *"more liquid secondary market could provide means for an auction participant in financial distress to sell its units and, therefore improve its financial situation"*². Snowy Hydro is concerned that if this does not occur and the market is illiquid, under the Westpac proposal it will require the TNSPs to be responsible for a shortfall in auction revenue.

Despite there only being one default of SRDU, we firmly believe that the risk must be managed. The Commission acknowledges *"as auction participants receive the optionality to sell their units"*³ they also need to *"be balanced against the possibility of increased speculation occurring in the market which may increase the risk of default"*⁴. A secondary/facilitated auction of SRDU is likely to encourage more speculation by speculators which is likely to increase the risk that TNSPs will receive less from SRDU auction proceeds.

² AEMC, 2017, "Draft Rule Determination National Electricity Amendment (Secondary trading of settlement residue distribution units) 2017", p31

³ *ibid*, p31

⁴ *ibid*, p31



Under the Westpac proposal TNSPs would be at risk of secondary SRA default. This is inconsistent with the principle that risk should reside with the party best able to manage the risk. Hence we support the Commission preferred Rule to separate Primary and Secondary SRA trades.

Under this distinction, TNSPs bear the risk of Primary SRA defaults and the secondary seller bears the risk of default for secondary SRA trades.

Cost Implications and Unquantifiable Benefits

Snowy Hydro notes that if there was little interest in secondary trading AEMO's estimate of the cost of implementation stated at \$285,000, could leave market participants with a large implementation bill. This cost could be a lot higher if AEMO has to make fundamental changes to the Westpac proposal such as the collection of monies/margins to manage the risk of a secondary trade default.

The Draft Determination does not provide a clear identification of benefits. Westpac noted that benefits to sellers include liquidity, simplified execution, reduced default and credit which are "extremely hard" to quantify. Snowy Hydro is concerned that the benefits have not been quantified but the extra costs are likely to be significant. The Commission should weigh up the benefit of secondary market against the costs before proceeding with the Final Determination.

Primary purpose of the Rule change

Westpac's rule change was about allowing AEMO to distribute SRA proceeds to another party other than TNSPs. It was not the Rule change Proponents intent to open the Rule change to questions about the merits of the primary market for SRDU and SDA and any comparisons or improvements are out of context and unnecessary.

Snowy Hydro are therefore pleased that the Commission's Draft Determination recognises that the current SRA remains fit for purpose and no further inquiry on this matter is necessary.

Snowy Hydro appreciates the opportunity to respond to the Draft Rule Determination. Any questions about this submission should be addressed to Panos Priftakis, Regulation Manager, by e-mail to panos.priftakis@snowyhydro.com.au.

Yours sincerely,



Kevin Ly
Head of Wholesale Regulation
Snowy Hydro

