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Project Energy Connect Market Integration Directions Paper

Pacific Energy Trading Pty Ltd (PET) appreciates the opportunity to provide comments on the Australian Energy Market Operator's (AEMO's) Project Energy Connect Market Integration Directions Paper. PET is broadly supportive of AEMO's proposed methodology for dealing with the introduction of loop flows to the NEM, so long as negative residues are allocated to TNSPs rather than SRA unit holders. Nevertheless, we contend that further analysis is required before moving forward.

Dispatch Integration Model

At earlier stages of consultation, a number of participants suggested AEMO explore the micro-slice model as an alternative to introducing loop flows into the NEM. This is consistent with the treatment of existing inter-regional loop flows, such as the loop formed by the Heywood and MurrayLink interconnectors, and with how PEC Stage 1 will be integrated into dispatch.

While Appendix A2 in the Directions Paper discusses the issues with this approach, it doesn't demonstrate that it is inferior or less equitable than the proposed model. Further modelling is required to compare the relative strengths and weaknesses of different approaches, noting that the micro-slice option has significant advantages in terms of simplicity and consistency with existing arrangements. Most importantly, in our view, the micro-slice option is more conducive of inter-regional hedging, so it is worth analyzing why it is not preferred.

Negative Residue Management

We appreciate AEMO's clear statement of the problem in the event that PEC is integrated into the NEM as a separate interconnector. It seems sensible to retain clamping in cases when there is net negative residue around the loop, though it would be useful to see modelled examples to understand how this would work in practice. Specifically, it is important to understand whether the clamping of a single leg of the loop would generally be sufficient to reduce negative residues or whether multiple legs need to be clamped. It is also important to see how frequently clamping occurs in practice and the impact on dispatch price outcomes.

When there is net positive residue around the loop, it makes sense to reallocate negative residues among the interconnectors in proportion to their contribution of positive residues accrued within a single dispatch interval. We agree with AEMO's arguments against reallocating all residue and against reallocating residue across different time periods.



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Reallocation of Residue

We agree with AEMO that net negative residues should continue to be allocated to TNSPs. As AEMO notes, allocating negative residues to SRA unit holders will reduce the hedging value of SRA units, ultimately leading to a reduction in inter-regional trade and competition.

This is a particular concern for South Australia, where, in our experience, a large portion of trade by non-vertically integrated retailers and independent traders occurs through or is supported by SRA units. Indeed, the total notional value of V-SA SRA units for a given quarter frequently exceeds the notional value of open positions in firm ASX derivatives for that quarter. While it is anticipated that the energization of PEC will improve hedging opportunities and liquidity in SA, this may be partly negated if negative residues are allocated to unit holders instead of TNSPs.

In the longer-term, it is expected that similar issues will arise in other regions, particularly in NSW once Eraring Power Station closes. With the volume of firm hedges reducing, it is important to preserve the effectiveness of alternative hedging sources, such as SRAs. This will aid in supporting auction clears, resulting in lower costs for customers.

While mindful that allocating negative residues to TNSPs may increase the need for cashflow management, we contend that these cashflows are small relative to the size of TNSP balance sheets and annual revenues. Furthermore, as AEMO notes, cashflow management issues should not be placed above hedging concerns.

If you would like to discuss any aspect of this submission, please contact Tom Waye at tom.waye@pacificenergytrading.com.au.

Regards,

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