



6 June 2024

Australian Energy Market Commission  
Level 15  
60 Castlereagh Street  
Sydney NSW 2000

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## ASX RESPONSE TO TRANSMISSION ACCESS REFORM CONSULTATION PAPER

ASX welcomes the opportunity to make a submission in response to the Australian Energy Market Commission's consultation paper on Transmission Access Reform. ASX's comments are focused solely on Question 7, relating to the impacts of the hybrid model on financial markets.

### Background

ASX is the primary energy derivatives exchange for Australia and New Zealand. ASX has a suite of energy contracts available across the Australian and New Zealand electricity and gas markets. All our electricity contracts are cash-settled, which enables physical markets participants to manage price risk, and non-physical participants such as banks and hedge funds to participate in the market without having to own the physical commodity.

Electricity futures contracts play a crucial role in energy markets by providing a mechanism for price discovery and risk management. Electricity futures contracts aid decision making as they reflect the aggregate expectation of future fair value. The futures market aggregates information from various market participants, such as producers, consumers, and traders, to form a transparent forward price curve that reflects anticipated supply and demand conditions. The futures market also provides opportunities for both generators and retailers to hedge their exposure to price risk.

Generators and retailers in the physical electricity market have three different options to manage price risk. They may:

- 1) Remain unhedged and be fully exposed to spot price movements
- 2) Use over-the-counter (**OTC**) bilateral contracting
- 3) Use energy derivatives, such as ASX electricity futures and options

There are various benefits to market participants using listed electricity derivatives (such as ASX electricity futures and options contracts as opposed to OTC contracting) including counterparty risk management, transparent pricing and market anonymity. There is also the added benefit of the large pool of liquidity that ASX offers, with ASX electricity volumes consistently accounting for 80-90% of all contracting volume in the Australian electricity market over the last few years.<sup>1</sup> ASX electricity contracting is now consistently over 600% of underlying demand in the underlying regions in the National Electricity Market (**NEM**). The trading of electricity futures contracts on a public market enhances market efficiency by providing continuous feedback on market expectations and future price trends, leading to more informed decision-making across the market.

In the 2022 Inquiry into the National Electricity Market Report, the ACCC identified access to exchange-traded and OTC hedging contracts as critical to allow electricity retailers and generators to manage their exposure to price and volume risk. The report also found that promoting access to, and liquidity in, financial markets is essential to maintaining competition in the wholesale and retail electricity markets.<sup>2</sup> Additionally, the COAG Energy Council notes in Australia's

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<sup>1</sup> AFMA Australian Electricity Derivatives Turnover Survey.

<sup>2</sup> ACCC Inquiry into the National Electricity Market, November 2022 Report, page 2.

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Strategic Energy Plan the importance of deep, liquid, and transparent financial markets for electricity and that contract liquidity is essential for the efficient operation of secondary markets.

Australian electricity futures first listed on ASX in 2002. There are a range of different electricity futures contracts available for trading, however they all settle against the average price of the relevant underlying physical market regional reference price (**RRP**) for the individual contract period. These contracts allow generators and retailers future price certainty for their hedged volume as they manage their price risk in the broader electricity market by essentially allowing them to lock in the price they will receive or pay in the underlying market as any gains or losses in the physical market are offset by losses or gains in the futures market.

#### **Comments on the proposed hybrid model's impact on financial markets**

ASX reiterates the concerns raised by other stakeholders about the proposed hybrid model's potential impact on financial markets and the consequential impact on physical market participants. ASX has concerns about the potential for multiple reference prices to fragment liquidity in the contract market, as well as the increased price risk that participants may have to take under the proposed hybrid model given the existing futures product(s) may become less suitable hedging tools.

As other submitters have identified, the proposed hybrid model would introduce basis risk through the movement in the difference between the RRP and the local prices that would be faced by participants under the congestion relief model (**CRM**). Such risk may create difficulties for generators to sell hedge cover and may increase the cost of hedge cover to retailers. It has the potential to undermine generators' and retailers' ability to hedge as their risks are no longer tied to the same price, with retailers facing the RRP and generators facing local prices under the CRM or volume risk if they do not opt-in to the CRM.

ASX has concerns that the liquidity of the derivative market may be affected, in turn affecting physical market participants' ability to hedge due to the changed risks and disparity in RRP outcomes. As noted above, all of ASX's Futures market products (Base Load Electricity Futures, Peak Load Electricity Futures and Base Load \$300 Cap Electricity Futures Contracts) are structured around settling against the average price of the RRP for the relevant underlying contract period and specification. Futures contracts provide a clear price signal and hedging tool for physical market participants and changes made that affect the pricing of the underlying market may affect the integrity of this forward price signal and the effectiveness of these contracts as a hedging tool. As identified by the Australian Financial Markets Association (**AFMA**) in previous submissions, reducing the volume of hedge contracts that units are able to sell is likely to complicate the business case for both investment in new controllable capacity and the continued operation of existing units.

Additionally, ASX notes that the Market Liquidity Obligation (**MLO**) requires market making on ASX under the Retailer Reliability Obligation (**RRO**). The MLO is a market making requirement designed to facilitate transparency and liquidity in the trading of electricity futures contracts relating to a forecast reliability gap. The RRO scheme was introduced to help ensure reliability in the NEM by having contracts available by certain generators to the market. The introduction of the CRM may have implications on the ability of the MLO entities to continue to provide suitable hedging contracts to the market.

ASX welcomes the opportunity to discuss the matters raised in this submission in more detail. If you have any questions, please contact Daniel Sinclair, Head of Commodities [REDACTED] or myself on the details below.

Kind regards

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