10th February 2006

Dr John Tamblyn, Chairman
Australian Energy Market Commission
1 Margaret Street
Sydney NSW 2000

Recovery of Negative Inter-regional Settlements Residue

1. Westpac Energy is a registered market trader and financial intermediary in the National Electricity Market registering among the most active market risk management participants in OTC, Futures and SRA derivatives. Within its wider operations, Westpac has significant debt and equity interests in the Australian energy market. The following response represents the views of the Westpac Energy group (Westpac).

2. Westpac supports the request (the Request) by the group of six generators and NEMMCO to make a Rule that would amend the NEMMCO derogation in Part 8 of Chapter 8A (Network Constraint Formulation) to manage negative settlement residues arising from network congestion in the Snowy region. In supporting the Request Westpac notes that the proposal could be implemented in a timely manner, which is of significant advantage to alternative proposals which could take several years. Westpac also notes it is our belief that uncertainty on flows, constraints, and negative residues has reduced the liquidity over the last two years in the trading of hedges between regions. This proposal will be positive in encouraging inter-regional trade of risk management products by providing a better risk management product for the market.

3. Westpac in supporting the Request refers to the paper submitted by Dr Daryl Biggar (ACCC economic consultant) to NEMMCO's Consultation for "Revision to Procedures for Management of Negative Residues" in 2005.

This paper by Biggar provides a proof that the negative residue on the Vic=>Sny interconnector is not a result of an inefficient despatch[1]. Additionally, any interventions by NEMMCO to control such negative residue introduces an **inefficiency** that was not initially present.

Currently, NEMMCO's imposition of a discretionary constraint that limits the Vic=>Snowy interconnector flow to zero when it had been as high as 900MW before such intervention is an inefficiency because the intervention removes supply competition into NSW. The Request to allow negative residues to occur in dispatch and subsequently be funded from the positive residues of the Snowy=>NSW units will improve market efficiency.

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[1] Dr D. Biggar, *"Management of Negative Residues on the VIC-Snowy and Snowy to NSW Directional Interconnectors"*, 20 May 2005. http://www.nemmco.com.au/dispatchandpricing/179-0241.pdf

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> *".....the appearance of negative settlement residues .....is merely a sign that the approach to dividing the merchandising surplus into separate payment streams is inappropriate. In this case, the appropriate policy response to the appearance of negative settlement residues merely amounts to "shifting funds around" from one stream of payments to another – no change to dispatch is necessary nor desirable...."*[2]

Clearly allowing the negative residue on the Vic=>Snowy interconnector results in (i) a much more efficient dispatch, and (ii) increases the ability to hedge inter-regionally as long as the total residue between the Victorian and NSW reference nodes is allocated in an appropriate manner.

5. Westpac concurs with the analysis in Appendix 2 of the Request that demonstrates that sufficient funds are available for funding the negative residues on the Vic=>Snowy interconnect with the positive residues allocated to the Snowy=>NSW interconnect.

5. In conclusion, Westpac fully supports the introduction of the proposed derogation and has a preference that it be introduced sooner rather than later in the interests of market efficiency.

We welcome the opportunity to meet and discuss our submission in more detail. Feel free to contact me at (02) 8254 9130.

Regards

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[2] Pg 4, Dr D. Biggar, *"Management of Negative Residues on the VIC-Snowy and Snowy to NSW Directional Interconnectors"*, 20 May 2005. http://www.nemmco.com.au/dispatchandpricing/179-0241.pdf