AEMC

Australian Energy Market Commission

Rule Determination

National Electricity Amendment (Preservation of Prudential Margin Through Call Notices) Rule 2008

Rule Proponent(s)
NEMMCO

27 November 2008

Signed: ....

Ian Woodward
Commissioner
For and on behalf of
Australian Energy Market Commission

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Citation

AEMC 2008, *Preservation of Prudential Margin Through Call Notices*, Rule Determination, 27 November 2008, Sydney

About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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Abbreviations

AEMC	Australian Energy Market Commission
Commission	see AEMC
MCE	Ministerial Council on Energy
MCL	Maximum credit limit
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NEO	National Electricity Objective
Rules	National Electricity Rules

Summary

Summary of the Rule change proposal

On 17 September 2008, the Australian Energy Market Commission (Commission) received a Rule change proposal from NEMMCO to address a perceived anomaly relating to clause 3.3.11(a)(2) of the National Electricity Rules (Rules). This clause specifies the formula to be used to calculate the call amount under the National Electricity Market's (NEM's) prudential regime.

The anomaly is illustrated in Figure 2 under section 1.2.2 of this document.

NEMMCO submitted that, in the event where a Market Participant's typical accrual exceeds its trading limit, the call amount calculated in accordance with clause 3.3.11(a)(2) of the current Rules will be insufficient to ensure that the Market Participant's outstandings are brought within its trading limit. An insufficient call amount results in the Market Participant's prudential margin being diminished.

The formula in clause 3.3.11(a)(2) of the current Rules essentially states that the call amount of a Market Participant is equal to the difference between its outstandings and typical accrual.

In order to ensure that a call notice will always be sufficient to bring the outstandings down to the trading limit level or below, hence preserves the prudential margin, NEMMCO proposed that the call amount formula be modified such that a call amount is equal to the higher of:

- the difference between the outstandings and typical accrual; and
- the difference between the outstandings and the trading limit.

The proposed change to the call amount formula was expected to preserve the prudential margin even in situations where the typical accrual is greater than the trading limit.

Consultation

On 16 October 2008, the Commission commenced initial consultation on this Rule change proposal by publishing a notice under s.95 and s.96 of the National Electricity Law (NEL) for a non controversial Rule change. The Rule change was open for public consultation for four weeks, with submissions closing on 13 November 2008. Interested parties were required to advise the Commission in writing by 30 October 2008 of an objection to expediting the making of the Rule.

The Commission did not receive any objections or submissions, and therefore makes the Rule using the expedited process.

The Commission's decision

The Commission makes this Rule and Rule determination on NEMMCO's "Preservation of Prudential Margin Through Call Notices" Rule change proposal, in accordance with sections 102 and 103 of the NEL.

The Commission considers that the proposed Rule will contribute towards achieving the national electricity objective (NEO) because it improves the operation of the NEM by rectifying an identified anomaly in the NEM prudential arrangements.

Rectifying the anomaly would make the NEM prudential regime more robust for both credit providers and payers, and reduces the risk to be factored into investment decisions in the NEM. The reduced risk is likely to promote efficient investment in electricity services for the long term interests of consumers of electricity.

For this reasons, the Commission considers that the Rule making test under s.88 of the NEL is satisfied.

This Rule is consistent with NEMMCO's proposed Rule.

Rule commencement

This Rule is scheduled to commence on 1 January 2009.

1 NEMMCO's Rule proposal

1.1 Summary of NEMMCO's Rule proposal

On 17 September 2008, the Australian Energy Market Commission (Commission) received a Rule change proposal from NEMMCO to address a perceived anomaly relating to clause 3.3.11(a)(2) of the National Electricity Rules (Rules). This clause specifies the formula to be used to calculate the call amount under the National Electricity Market's (NEM's) prudential regime.

NEMMCO considered the proposed Rule change to be non-controversial because in its view, the proposed Rule would be unlikely to have a significant effect on the NEM. NEMMCO therefore requested that the Commission makes the Rules using an expedited consultation process, under s.96 of the National Electricity Law (NEL).

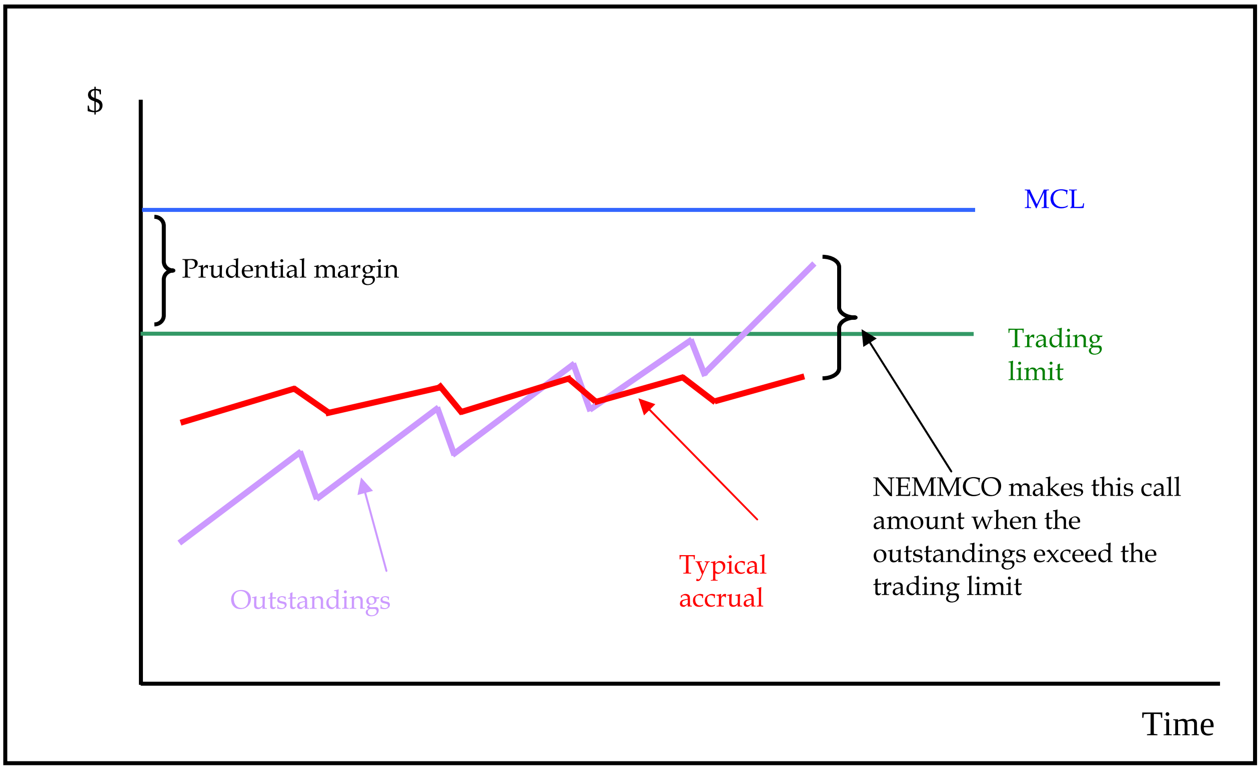
1.2 Context and Background

1.2.1 Prudential requirements for the NEM

This section contains a broad description of elements of the NEM prudential requirements that are relevant to this Rule change proposal.

The elements of NEM prudential requirements are illustrated in Figure 1.

Figure 1: Elements of NEM prudential requirements



1.2.1.1 Maximum Credit Limit (MCL), trading limit and prudential margin

Under clause 3.3.8 of the Rules, NEMMCO is required to determine a MCL and prudential margin for each Market participant. Market Participants are required to lodge credit support with NEMMCO to the level of at least their MCL.

Each Market Participant has a trading limit, which is specified in clause 3.3.10 to be the Market Participant's level of credit support less its prudential margin.

The prudential margin represents the buffer below the MCL which sets the limit under which a Market Participant is permitted to trade. Its purpose is to ensure that NEMMCO is not exposed to a prudential risk during the period of removing a Market Participant from the NEM.

1.2.1.2 Prudential monitoring process and outstandings

NEMMCO computes the outstandings through its prudential monitoring process.

The outstandings of a Market Participant is a dollar amount determined in accordance with clause 3.3.9 of the Rules. This broadly represents the net settlement amount payable by the Market Participant, up to the present time, irrespective of whether the payment date has been reached, and net of any security deposits that have been made to NEMMCO.

1.2.1.3 NEMMCO's call notice

If a Market Participant's outstandings exceed its trading limit, NEMMCO may issue a call notice. NEMMCO calculates the call amount in accordance with clause 3.3.11(a)(2) of the Rules. The call amount is equal to the difference between a Market Participant's outstandings and its typical accrual.

This clause also provides that a call amount must always be greater than or equal to zero.

The typical accrual is defined in clause 3.3.12. It is an amount determined by NEMMCO that is broadly equal to the level of outstandings that the Market Participant would have reached if spot prices and consumption had been at average levels. Details of how a Market Participant's typical accrual is calculated are set out in a NEMMCO procedure[1].

1.2.2 The issues

NEMMCO identified an anomaly in clause 3.3.11(a)(2) of the Rules. In the event where a Market Participant's typical accrual exceeds the trading limit, the call

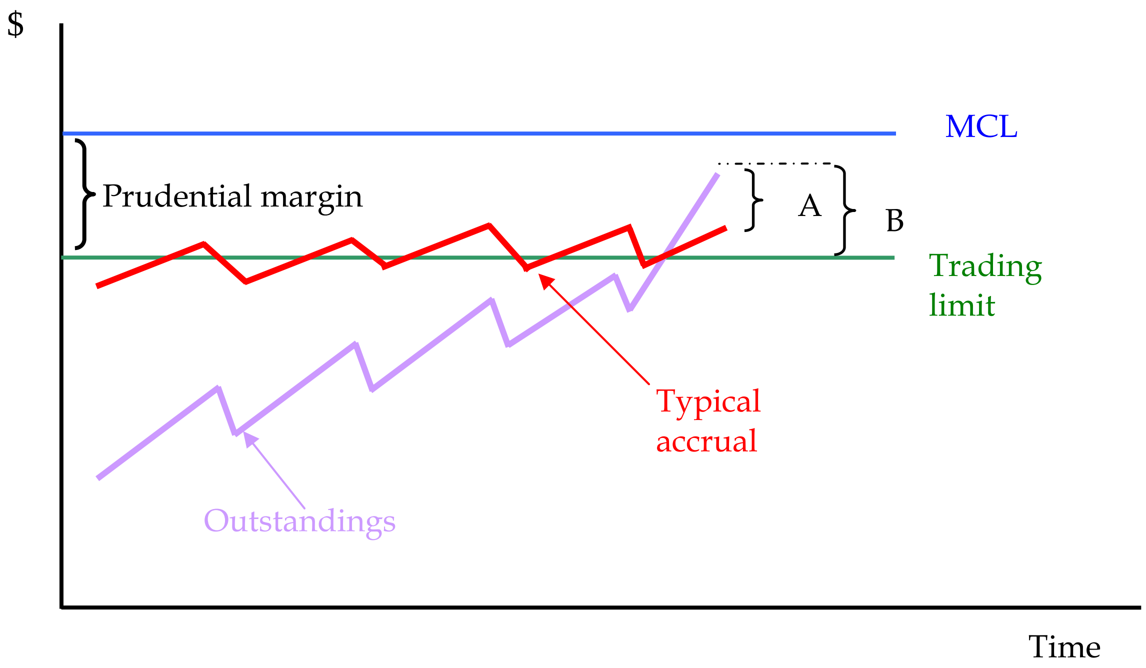
[1] NEMMCO, 2008, *Method for Determining Maximum Credit Limit and Prudential Margin*, http://www.nemmco.com.au/met_sett_sra/538-0006.html

amount calculated in accordance with the current Rules will be insufficient to ensure that the Market Participant's outstandings are brought within its trading limit.

An insufficient call amount results in the Market Participant's prudential margin being diminished.

This anomaly is illustrated in Figure 2 below.

Figure 2: Anomaly in clause 3.3.11(a)(2) of the Rules



- Under the current Rules, the call amount NEMMCO can make is "A" when the outstandings exceed trading limit.
- However, the call amount required to bring the outstandings to the trading limit (hence preserves the prudential margin) is "B".
- Therefore, the current Rules do not allow a sufficient call amount to be made if the typical accrual exceeds the trading limit.

In some specific circumstances, there could be a zero call amount even though the Market Participant's outstandings to NEMMCO exceed the trading limit.

1.3 NEMMCO's Rule change proposal

NEMMCO proposed to rectify the anomaly by modifying the formula in clause 3.3.11(a)(2) of the Rules.

Under the current Rule, this formula essentially states that the call amount of a Market Participant is equal to the difference between the outstandings and typical accrual.

In order to ensure that a call amount will be sufficient to bring the outstandings down to the trading limit level or below, hence preserves the prudential margin, NEMMCO proposed that the call amount formula be modified such that a call amount is equal to the higher of:

- the difference between the outstandings and typical accrual; and
- the difference between the outstandings and the trading limit.

The proposed change to the call amount formula is expected to preserve the prudential margin even in situations where the typical accrual is greater than the trading limit.

1.4 Consultation on NEMMCO's Rule change proposal

The consultation process for this Rule change request is illustrated in Table 1.

Table 1: Determination process for the Rule change proposal

Date	Determination process
16 October 2008	The Commission commenced the Rule determination process by publishing a notice under s.95 and s.96 of the NEL.
30 October 2008	Closing date for objections to the expedited process.
13 November 2008	Close of consultation.
27 November 2008	Final Rule determination.

On 16 October 2008, the Commission commenced initial consultation on this Rule change proposal by publishing a notice under s.95 and s.96 of the NEL for a non-controversial Rule change. The Rule change was open for public consultation for four weeks, with submissions closing on 13 November 2008. Interested parties were required to advise the Commission in writing by 30 October 2008 of an objection to expediting the making of the Rule.

The Commission did not receive any objections or submissions, and therefore makes the Rule using the expedited process.

2 Methodology for making the final Rule determination

The Commission has determined in accordance with sections 102 and 103 of the NEL to make this Rule.

This final Rule determination sets out the Commission's reasons for making the Rule.

The Commission has taken into account:

- the Commission's powers under the NEL to make the Rule;
- the Commission's analysis as to the ways in which the Rule will or is likely to contribute to the achievement of the national electricity objective (NEO) so that it satisfies the statutory Rule making test; and
- any relevant Ministerial Council on Energy (MCE) statements of policy principles.

2.1 The Commission's power to make the Rule

The Commission is satisfied that the final Rule falls within the subject matters for which the Commission may make Rules, as set out in section 34 of the NEL.

The final Rule relates specifically to item 34(1) of the NEL, which states that:

"…the AEMC, in accordance with this Law and the Regulations, may make Rules, to be known, collectively, as the "National Electricity Rules", for or with respect to—

(a) regulating—

(i) the operation of the national electricity market;

….

(iii) the activities of persons (including Registered participants) participating in the national electricity market or involved in the operation of the national electricity system;"

The proposed Rule sought to address an anomaly in the prudential regime of the NEM and therefore relates to: (a) the operation of the NEM; and (b) the activities of persons participating in the NEM or involved in the operation of the national electricity system. Specifically, the proposed Rule is within matters set out in Schedule 1 to the NEL, as it relates to the prudential requirements to be met by a Registered Participant.

2.2 Assessment of the proposed Rule: the NEO, the Rule making test and the MCE statement

The NEO is the basis of assessment under the Rule making test and is set out in Section 7 of the NEL:

> "The objective of this Law is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system."

The Rule making test states:

> "(1) The AEMC may only make a Rule if it is satisfied that the Rule will or is likely to contribute to the achievement of the national electricity objective;
>
> (2) For the purposes of subsection (1), the AEMC may give such weight to any aspect of the national electricity objective as it considers appropriate in all circumstances having regard to any relevant MCE statement of policy principles"[2]

Section 2.4 contains the Commission's assessment of the extent to which the Rule promotes the NEO and satisfies the Rule making test.

In addition, the NEL requires the Commission to have regard to any MCE statements of policy principles in applying the Rule making test. The Commission notes that currently there are no MCE statements of policy principles that relate to the issues contained in this Rule change proposal.

2.3 Submissions received on the Rule change proposal

There were no submissions received on the Rule change proposal.

2.4 The Commission's test of the NEO

The Commission considers that the proposed Rule will contributes towards achieving the NEO because it improves the operation of the NEM by rectifying an identified anomaly in the NEM prudential arrangements.

[2] Section 88 of the National Electricity Law.

The anomaly potentially results in call amounts by NEMMCO that are insufficient to preserve the prudential margin. This reduces the ability of the prudential regime to protect credit providers from the effects of a default event.

Rectifying the anomaly would make the prudential regime more robust for both credit providers and payers, and reduces the risk to be factored into investment decisions in the NEM. The reduced risk is likely to promote efficient investment in electricity services for the long term interests of consumers of electricity.

For this reason, the Commission considers that the Rule making test under s.88 of the NEL is satisfied.

2.5 Differences between the proposed Rule and Rule to be made

The Commission has adopted all of NEMMCO's proposed Rule changes.

2.6 Rule commencement

This Rule is scheduled to commence on 1 January 2009.

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A Commission's Analysis of the Proposed Rule

In this Appendix the Australian Energy Market Commission (Commission) addresses the issues that were raised in NEMMCO's Rule change proposal and submissions.

A.1 NEMMCO's Rule proposal

NEMMCO's identified an anomaly in clause 3.3.11(a)(2) of the National Electricity Rules (Rules) and suggested amendments to address this anomaly.

In the event where a Market Participant's typical accrual exceeds the trading limit, the call amount calculated in accordance with the current Rules will be insufficient to ensure that the Market Participant's outstandings are brought within its trading limit. This would result in the Market Participant's prudential margin being diminished.

The call amount of a Market Participant is essentially equal to the difference between its outstandings and typical accrual.

NEMMCO suggests that clause 3.3.11(a)(2) of the Rules be modified so that the prudential margin is preserved even in situations where the typical accrual is greater than the trading limit.

A.2 The Commission's consideration and reasoning

The Commission considers that the Rule change proposed by NEMMCO should be implemented because modifying clause 3.3.11(a)(2) of the Rules will ensure that the call amount issued by NEMMCO is sufficient to preserve the prudential margin of a Market Participant.

This would make the prudential regime more robust for both credit providers and payers, and reduces the risk to be factored into investment decisions in the National Electricity Market (NEM). The reduced risk is likely to promote efficient investment in electricity services for the long term interests of consumers of electricity, and therefore contributes towards the national electricity objective (NEO).

The Commission did not receive, and therefore have not considered, any submissions in relation to this Rule change proposal.

A.3 The Commission's finding in relation to this issue

The Commission accepts NEMMCO's Rule change proposal to modify 3.3.11(a)(2) of the Rules such that a call amount is equal to the higher of:

- the difference between the outstandings and typical accrual; and
- the difference between the outstandings and the trading limit.

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