

Mr Peter Adams  
National Electricity Code Administrator  
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Dear Mr Adams

### SETTLEMENT RESIDUE AUCTION CLAUSE 3.6.5

Macquarie Generation supports the NEMMCO proposal to change Settlement Residue Auction Clause 3.6.5, as detailed in NEMMCO's letter to NECA dated 8 February 2005.

Macquarie Generation agrees that there is a significant issue with the recovery of negative inter-regional settlement residues from either positive residues within the same billing period (week) or from future settlement residue auction (SRA) fees. NEMMCO acknowledges that the current process was designed on the assumption that negative residues would not be significant.

It is likely that negative residues will continue to grow if the Ministerial Council on Energy decides to apply Option 4 as the standard constraint option formulation for the NEM. Currently, only intra-regional constraints at Tarong and Snowy contribute to counter price flows. The introduction of Option 4 across the NEM will increase the number of locations where negative settlement residues could occur.

Macquarie Generation supports NEMMCO's proposal to use SRA proceeds for covering actual negative residues. Auction fees were originally intended to cover NEMMCO's costs in conducting the auction process. Using auction proceeds will ensure a more stable source of revenue to cover negative residues than using auction fees and will result in an efficient allocation of these negative residues.

NEMMCO stated in its proposal that the "efficiency of the SRA process will be enhanced by having a substantial number of parties participating." It follows that NEMMCO should provide a clear guarantee that it will continue to proactively manage counter-price flows to maximise SRA interest and participation.

Existing practice has NEMMCO netting negative residues from positive residues within the same billing week. While supporting the NEMMCO proposal, Macquarie Generation believes that there is a case to extend the Code change by eliminating the netting process so that all negative residues in any trading interval are recovered separately from future auction proceeds. There is no clear economic reason why settlement residue unit holders should effectively fund negative residues resulting from network constraints and high demand.

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According to NEMMCO's quarterly auction reports, the largest quarterly negative residue in the past two years was in Q4 2003. A single event in the Queensland region caused counter price flows into New South Wales resulting in a \$2 million negative residue. Auction proceeds from the following quarter, Q1 2004, for the Queensland-New South Wales interconnector were around \$4.1 million.<sup>1</sup> Under Macquarie Generation's proposed amendment, the negative residue would have been netted from the next quarter's auction proceeds, resulting in \$2.1 million being passed to the relevant TNSP.

This amendment would promote two positive outcomes. The first would be that the relevant TNSP and customers would be allocated the costs of contributing to negative settlement residues. Customer load during high demand periods causes increased stress on the network, directly contributing to constraints. The amendment is consistent with the argument for recouping negative residues for a particular billing period from future auction benefits as a way of directly targeting those parties that contribute the most to those costs.

The second benefit would be a possible increased interest in SRA participation given the possibility of higher residues and an increase in the 'firmness' of SRAs. This could contribute to higher future auction proceeds from which to recover future negative settlements.

Macquarie Generation believes NEMMCO's proposed Code change supported by the proposed amendment to abolish the netting process and a clear guarantee from NEMMCO that it will continue proactively managing counter price flows would address the problem of growing SRA fees.

Yours faithfully



RUSSELL SKELTON  
MANAGER MARKETING & TRADING

21 March 2005

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<sup>1</sup> NEMMCO Auction Report 2004-1 prepared by the Settlement Residue Committee, Version 1.0.