

Review into the role of hedging contracts in the existing NEM prudential framework – Terms of Reference

Under section 45 of the National Electricity Law (NEL), the Australian Energy Market Commission (Commission) has initiated a review into the potential use of futures and other types of contracts in the National Electricity Market (NEM) prudential framework.

Objective of the review

In this review, the Commission is seeking to provide advice to the Ministerial Council of Energy (MCE) on ways in which NEM participants' futures and other types of contracts can be integrated into the NEM prudential framework with the objective of enhancing the operation and efficiency of that regime.

Scope of the review

The scope for this review includes:

- investigating the feasibility of developing a mechanism to offset the prudential requirement of a NEM market participant using its contract position;
- investigating the feasibility of incorporating futures prices in the MCL methodology;
- investigating and developing any other appropriate proposals that may enable NEM participants' contract positions to be taken into account so as to enhance the NEM prudential framework;
- as appropriate, legal analysis of the potential design, and statistical or other suitable analysis to confirm the costs and benefits, of any such proposals; and
- as appropriate, determining the final design of any such proposals (this includes, but is not limited to, appropriate information, reporting and data requirements);
- as appropriate, development of proposed National Electricity Rules to implement these arrangements.

The scope of the review will seek to identify solutions within the context of the Rules framework.

Working Group

The Commission will establish a working group to provide expert advice relating to the review.

This working group may consist of members with the following areas of expertise:

- Rule change process;
- NEM prudential framework;
- relevant financial market knowledge;
- legal knowledge;
- knowledge of the issues from a NEM generator's perspective;
- knowledge of the issues from a NEM retailer's perspective; and
- any other areas of expertise deemed suitable by the Commission to assist in the review process.

Approach to the review

In seeking to address the above objectives, the Commission will undertake a staged approach.

The two stages are as follows:

- **Stage 1:**
 - a) will identify mechanisms to integrate futures and other types of contracts into the NEM prudential regime, including:
 - the issues associated with a mechanism which offsets the prudential requirement of a NEM market participant using its contract position;
 - the issues associated with applying futures price information to determine the MCL for a NEM market participant;
 - where possible, identify solutions for the issues, and recommend an arrangement for offsetting the prudential requirement of a NEM market participant and/or a revised MCL methodology;

b) where there is no feasible solution for the issues, conclude the review process without making a recommendation.

- **Stage 2:** as appropriate, will develop draft Rules to support the recommendations made in Stage 1.

Considerations

In conducting this review, the Commission will have regard to:

- the national electricity objective;
- MCE statement of policy principles;
- previous reviews and Rule determinations relating to reallocations or Futures Offset Arrangements;
- other relevant previous reviews and Rule change determinations;
- expert advice from the working group; and
- any other relevant information.

This review will be conducted in an open and transparent manner to provide all interested stakeholders with the opportunity to contribute at each stage of the review process. The Commission will have regard to stakeholders' opinions raised during the course of the review.

Timing and outputs

The Commission will deliver the following outputs for this review:

- A **Framework and Issues Paper**, which will identify and consult on the range of issues requiring consideration and inform interested parties on the Commission's proposed assessment criteria;
- A **Stage 1 Draft Report**, which will set out the Commission's proposed recommendations on the appropriate mechanisms in which to integrate NEM market participants' contract positions into the NEM prudential regime. This report will be published to invite submissions from stakeholders; and
- A **Stage 1 Final Report**, which will set out the Commission's final recommendations. The Commission will provide this report to the MCE for its consideration. The Commission will also brief the MCE on its findings.

This process for Stage 1 can be summarised as follows:

Milestone	Timing
Framework and Issues Paper	March 2009
Framework and Issues Public Forum	April 2009
Stage 1 Draft Report	June 2009
Public Forum	July 2009
Stage 1 Final Report to MCE	September 2009

In Stage 2, where appropriate, the Commission would draft recommended Rules to support its recommendations in Stage 1. The Commission intends to submit any such proposed Rules to the MCE by December 2009. Stakeholders will be given an opportunity to comment on any draft proposed Rules before the Commission provides them to the MCE for consideration.