RULE CHANGE REQUEST: EXTENSION OF CALL NOTICE TIMING

PREPARED BY: Market Development

DATE: 25 July 2013

Contents

Note: Unless stated otherwise, all references to times are in Local Sydney time.

1 Summary

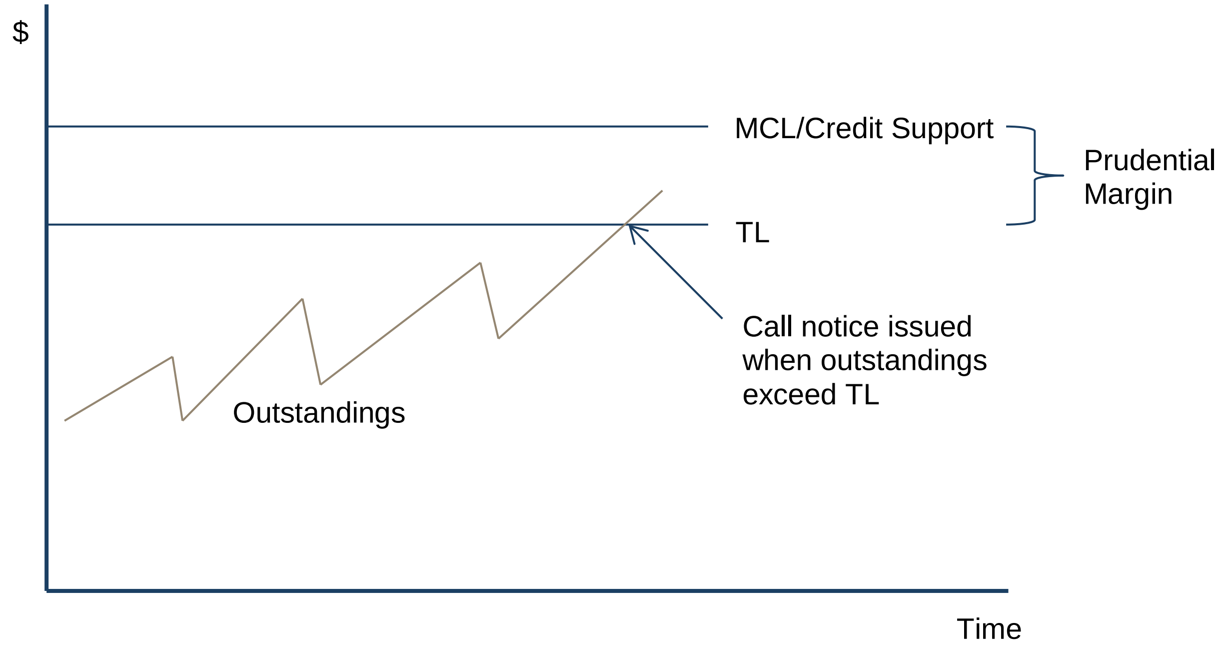
AEMO requests clause 3.3.13(b) of the National Electricity Rules (NER) be amended to extend the time a call notice takes effect on the same business day from noon to 1:00 PM. This change would allow Market Participants who have breached their Trading Limit (TL) in the National Electricity Market (NEM) more time to confirm whether additional funding is available from their Sydney Futures Exchange (SFE) trading position, prior to AEMO issuing a call notice. It would also assist Market Participants located in Queensland during Eastern Daylight Savings Time (EDST) when time differences could make it more difficult to manage TL breaches.

2 Background

Market Participants purchase and sell energy in the NEM in half hourly trading intervals and financial settlement is based on seven day billing periods. Each billing period is settled 20 business days from the end of that billing period. Market Participants may accrue liabilities in the NEM up to their TL. The TL is set as the credit support provided by the Market Participant less the prudential margin, where the minimum level of credit support provided by the Market Participant is the maximum credit limit (MCL). Market Participants are required to lodge credit support in the form of bank guarantees with AEMO.

If a Market Participant’s outstandings (their accrued net liabilities in the NEM) exceed their TL on a given day, AEMO allows the Market Participant until 10:30 AM to manage its financial position, either by reducing its outstandings or increasing its TL. Outstandings can be reduced by provision of a security deposit, or ex-post credit reallocation, and a TL can be increased through the provision of additional credit support. If a Market Participant does not manage a TL breach, AEMO may issue a call notice under clause 3.3.11 of the NER. Figure 1 illustrates this.

Figure 1: Key elements of the NEM prudential framework



Currently, if AEMO issues a call notice prior to noon, the Market Participant must respond by 11:00 AM the following day.[1] If AEMO issues a call notice after 12 noon, the call notice is deemed to have been issued on the next business day.[2] If this were to occur at the start of the week, the Market Participant might not need to respond until 11:00 AM two days later. If the call notice were to be issued on a Friday afternoon, it could be deemed to have been issued on the following Monday, therefore the Market Participant would not be required to respond until Tuesday, four days later. During public holidays, it could be even longer, particularly if the call notice were to be issued after noon on the Thursday before Good Friday, with a response deadline six days later. During this time, the Market Participant can continue to trade on the market, increasing the level of their outstandings well beyond the MCL.

2.1 Process for managing a TL breach

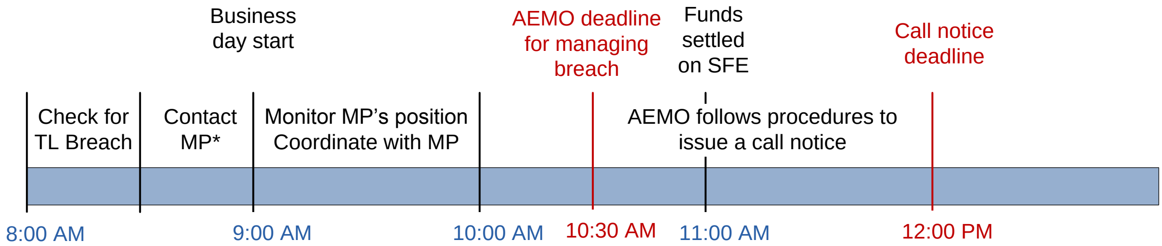
If a Market Participant breaches its TL overnight, AEMO contacts the Market Participant to discuss the action the Market Participant will take to rectify the breach. Typically, AEMO will initiate contact between 8:30 AM to 9:00 AM the following morning.

AEMO requires up to 1.5 hours complete its processes to issue a call notice. Consequently, AEMO allows Market Participants until 10:30 AM to manage a TL breach. If AEMO has reason to believe the TL breach is not going to be rectified in a timely fashion at the expiry of this period, AEMO will escalate the matter and draft a call notice. Hence, a call notice will be issued after 10:30 AM and prior to noon.

If a TL breach is observed it would not be prudent for AEMO to delay issuing a call notice because the affected Market Participant's outstandings could continue to grow significantly, increasing the level of risk in the NEM.

Figure 2 sets out the typical timeline for AEMO's call notice process.

Figure 2: Call Notice Process Timeline



* MP = Market Participant

To prevent a TL breach, a Market Participant only needs to provide sufficient collateral to reduce its outstandings below its TL. However, when a call notice is issued under NER clause 3.3.11(a)(2), the affected Market Participant must provide sufficient collateral to return to its typical accrual amount. This amount would be greater than that required to manage a breach prior to a call notice being issued.

[1] Refer to clause 3.3.13 of the NER.

[2] Refer to clause 3.3.13(b) of the NER.

3 Issue

AEMO considers that, in certain circumstances, the time allowed under NER clause 3.3.13(b) provides insufficient time prior to issuing a call notice:

- During EDST, for Queensland-based businesses, to arrange credit support.
- For Market Participants to access funding from markets such as the Sydney Futures Exchange.

The following sections describe these issues in more detail.

3.1 Eastern Daylight Savings Time

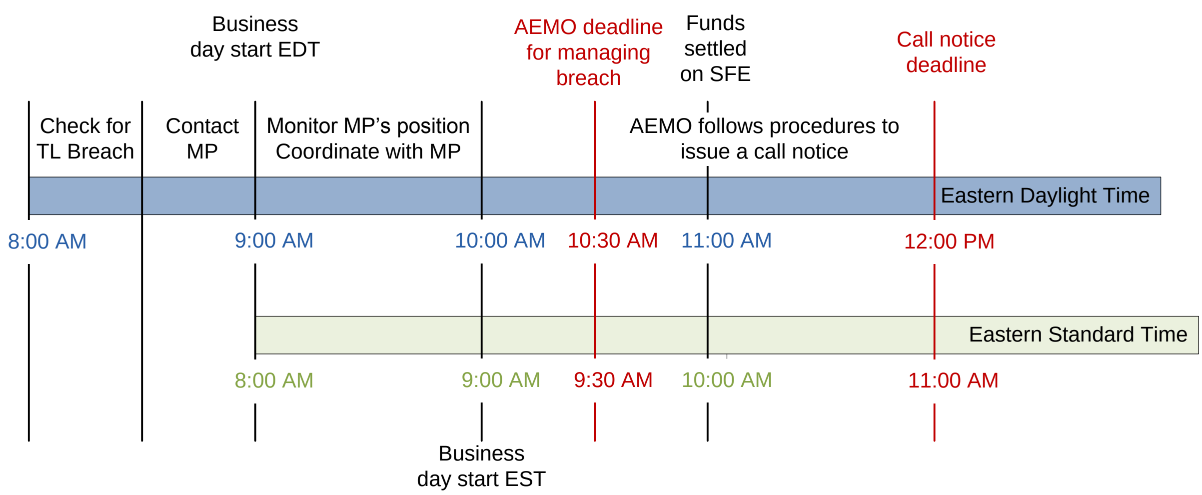
During EDST, Queensland-based organisations commence their business day an hour later than other eastern states. Due to this time difference:

- AEMO may be unable to alert Queensland-based Market Participants that there has been a TL breach until they commence work at 9:00 AM (EST) which would be 10:00 AM (EDST).
- Market Participants that can be contacted earlier might also depend on other local businesses being open to be available to discuss their financing arrangements.

Figure 3 highlights the difference in timing for Queensland businesses during EDST. There might be as little as 30 minutes to resolve a TL breach, before AEMO is required to commence its processes to issue a call notice.

A delay in timing will assist Queensland businesses during EDST when AEMO's 10:30 AM (EDST) (Sydney time) deadline occurs at 9:30 AM (EST) (Queensland time). It will also avoid time required for AEMO and Market Participants to address the issue or address administrative banking issues that might be causing the need for the issue of a call notice.

Figure 3: Call notice timing during EDST



3.2 Access to funding from the SFE

Market Participants draw funds and credit from a number of sources and the overall level of credit available to a Market Participant depends on a portfolio of investments. The SFE settles cash margin transactions at 11:00 AM. By this time, AEMO would have commenced its processes to issue, or would have already issued, a call notice to a Market Participant.

Extending the call notice deadline would allow Market Participants additional time to leverage additional funds based on their SFE call margin positions to use in the management of their credit position with AEMO.

This would reduce payment and settlement risk associated with securing funds to rectify the TL breach.

4 Request for a Non-controversial Rule

AEMO requests that the AEMC considers this as a 'non-controversial Rule' request under section 96 of the National Electricity Law (NEL). Consistent with the definition of a 'non-controversial Rule' in section 87 of the NEL, AEMO considers that the proposed rule would have an insignificant effect because:

- This change does not alter the default and suspension timelines and, hence, does not increase prudential risk.
- This change would only affect Market Participants whose outstandings are above their TL.
- While providing additional scope for some Market Participants to better manage TL breaches and risk, it does not materially affect market incentives or operation of the NEM.
- Discussions with stakeholders indicate broad agreement for this change and that it would not significantly impact NEM operation.

4.1 Stakeholder engagement

AEMO has discussed this rule change with energy market stakeholders, primarily through the Settlement Managers Working Group (SMWG).[3] The SMWG has indicated unanimous support for this proposal, and agreed that it presented no additional risk in terms of the timelines for managing a potential default event. The SMWG also noted that the additional time would be valuable to those Market Participants located in Queensland during EDST in the southern states.

The rule change was also discussed at two of AEMO's NEM Wholesale Consultative Forum meetings. The proposal attracted general support and no objections were raised.

AEMO notes that the AEMC recommended to delay the call notice timing in its Role of Hedging Contracts in the Existing NEM Prudential Framework Review. [4] In this review, the recommendation was part of the proposed futures offset arrangements (FOA) to assist in accommodating possible delays under SFE processes. While FOA arrangements have not been implemented, AEMO considers the change in timing will still be of benefit to Market Participants who trade on the SFE.

[3] The SMWG is a working group convened by AEMO, comprising of settlement managers from energy market stakeholders, to provide a forum to consider settlement and prudential matters in the energy markets operated by AEMO.

[4] AEMC Final Report Review into the role of hedging contracts in the existing NEM prudential framework: http://www.aemc.gov.au/Market-Reviews/Completed/review-into-the-role-of-hedging-contracts-in-the-existing-nem-prudential-framework.html.

5 Proposed Rule

The proposed rule would amend clause 3.3.13(b) of the NER to change the time AEMO gives a call notice to a Market Participant from noon to 1:00 PM (Sydney time).

AEMO's suggested drafting follows:

> If *AEMO* gives a *call notice* to a *Market Participant* after ~~noon~~ 1:00 pm (*Sydney time*), then *AEMO* is deemed to have given that *call notice* on the next *business day* for the purposes of this clause.

6 How the Proposed Rule Contributes to the National Electricity Objective

Before the AEMC can make a Rule change it must apply the rule making test set out in the NEL, which requires it to assess whether the proposed Rule will or is likely to contribute to the National Electricity Objective (NEO). Section 7 of the NEL states the NEO 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, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

AEMO considers the proposed rule promotes the efficient operation of electricity services because it would:

- Provide Market Participants with more time to manage their financial obligations by obtaining more information on their SFE call margin status that could be used to source additional funding in managing their TL breach.
- Improve the efficiency of AEMO and Market Participants' processes by reducing time spent consulting and responding to TL breach warnings, particularly as a high percentage of breaches subsisting after 10.30 AM are due to administrative banking issues. It could also avoid the need for AEMO and Market Participants to escalate issues internally and for AEMO to draft call notices.
- Provide Queensland Market Participants with a more reasonable amount of time to manage TL breaches during daylight savings prior to AEMO issuing a call notice.

7 Expected Benefits and Costs of the Proposed Rule

AEMO expects the proposed rule would benefit Market Participants by allowing them to leverage off their current hedging arrangements. Extending the time a call notice takes effect on the same business day from noon to 1:00 PM would assist Market Participants (particularly Queensland businesses during EDST) to access capital from other sources, such as the SFE, to rectify a TL breach.

AEMO considers that the proposed rule could reduce risk in the NEM. Once AEMO issues a call notice, the affected Market Participant is required to settle the call amount requiring it to access funds to restore its outstandings to its typical accrual amount. Failure by the Market Participant to meet the call notice by the due time can lead to suspension from the market and triggering of Retailer of Last Resort processes. AEMO's prudential management approach is, wherever possible, to issue call notices by the deadline specified in the NER that would require the call notice to be met by 11:00 AM the following business day. This prevents defaulting Market Participants having an additional day to respond, during which time additional outstandings would continue to accrue. The proposed rule would provide affected Market Participants additional time to remedy a TL breach and, potentially, access additional funds for this purpose from SFE settlement, prior to the deadline for AEMO issuing a call notice. This would be achieved without increased risk to other Market Participants.

The proposed rule would allow AEMO to avoid costs associated with the operational effort spent drafting call notices and escalating failures to rectify a TL breach by 10:30 AM. Similarly, Market Participants would avoid the time spent and costs of dealing with a call notice. AEMO estimates that its avoided administration costs would be around $12,000 per annum.

The implementation cost of this change to AEMO and Market Participants is minimal because it requires only a procedural change.