

Inquiries

The Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

Citation

AEMC 2009, (*EnergyAustralia Participant Derogation Extension (Settlement Residue Auctions)*), Rule Determination, 11 June 2009, 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.

This work is copyright. The Copyright Act 1968 permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

Contents

Contents	iii
Abbreviations	iv
Executive Summary	v
1. EnergyAustralia's Rule Change Proposal	1
1.1 Proposal	1
1.2 Problem to be addressed by the Rule Change Proposal	1
1.3 Proponent's Proposed Solution	2
1.4 Consultation	2
2 Rule Determination	3
2.1 Commission's Determination	3
2.2 Commission's Considerations	3
2.3 Commission's power to make the Rule	4
3 Commission's Assessment against NEL Criteria	5
3.1 Methodology	5
3.2 Rule making test and the National Electricity Objective	5
3.3 Background	5
3.4 Request for an extension to participant derogation - 2009	9
3.5 Assessment against Rule making test	10

Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Commission	see AEMC
EA	EnergyAustralia
IRSR	Inter-regional settlement residue
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NER	See Rules
Rules	National Electricity Rules
SRA	Settlement residue auction
TNSP	Transmission Network Service Provider

Executive Summary

On 30 March 2009 the Australian Energy Market Commission (Commission) received a Rule change proposal from EnergyAustralia (EA) seeking an extension to EA's existing Participant Derogation that permits EA to participate in settlement residue auctions (SRAs).

EA proposed that the sunset date applicable to its existing Participant Derogation be extended by three years to 30 June 2012.

The Commission decided to expedite the Rule Change Proposal under section 96 of the National Electricity Law (NEL) as it considered that the proposed Rule would be unlikely to have a significant effect on the national electricity market (NEM). This is because it proposed to extend existing arrangements. No objections to the expedited process were received. One submission was received from the National Electricity Market Management Company (NEMMCO) on the 2009 Rule change proposal.

In accordance with section 102 of the NEL the Commission has made and published this Rule determination. In accordance with section 103 of the NEL the Commission has made the *National Electricity Amendment (EnergyAustralia Participant Derogation Extension (Settlements Residue Auctions)) Rule 2009 (Rule as Made)* in the manner proposed by EA.

The Rule as Made will commence on 1 July 2009.

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the National Electricity Objective.

This page has been intentionally left blank

1. EnergyAustralia's Rule Change Proposal

1.1 Proposal

On 30 March 2009 the Australian Energy Market Commission (Commission) received a Rule change proposal from EnergyAustralia (EA) seeking an extension to EA's existing Participant Derogation that permits EA to participate in settlement residue auctions (2009 Rule Change Proposal).¹

In 2006 the Commission made the *National Electricity Amendment (EnergyAustralia Participant Derogation (Settlement Residue Auctions)) Rule 2006 No. 9* (2006 Rule). EA has proposed that the sunset date applicable to the 2006 Rule be extended by three years to 30 June 2012.²

EA submitted that the proposed Rule is non-controversial and therefore requested that the Rule-making process be expedited in accordance with section 96 of the National Electricity Law (NEL).³

1.2 Problem to be addressed by the Rule Change Proposal

The 2009 Rule Change Proposal sets out the basis for its request for an extension of the 2006 Rule, the key points of which are noted below.

EA operates electricity distribution and energy retail businesses in the National Electricity Market (NEM). Part of EA's distribution infrastructure has been classified as transmission infrastructure. EA is therefore a registered transmission network service provider (TNSP) under the National Electricity Rules (NER or Rules).

As retailer EA executed an auction participation agreement with the National Electricity Market Management Company (NEMMCO) and commenced participating in settlement residue auctions (SRAs) in March 2001.⁴

Prior to 1 July 2005 NEMMCO had discretion as to whether TNSPs were able to enter into settlement residue distribution agreements. However, on 1 July 2005 clause 3.18.2(g)(2) of the NER was amended to prohibit TNSPs from entering into auction

¹ EnergyAustralia 2009, *Request for Participant Derogation to the National Electricity Rules re EnergyAustralia's participation in Settlement Residue Auctions*, 30 March 2009. Under section 91(5) of the NEL a participant may request the AEMC to make a participant derogation that relates to that participant.

² 2009 Rule Change Proposal, p.2

³ 2009 Rule Change Proposal, p.1

⁴ NEMMCO and EnergyAustralia 2006, *Request for Participant Derogation to the National Electricity Rules re EnergyAustralia's participation in Settlement Residue Auctions*, 13 April 2006, p.7 (2006 Rule Change Proposal).

participation agreements with NEMMCO. This amendment effectively excluded EA from participating in SRAs.

NEMMCO and EA jointly submitted a Rule change request to provide EA with the unambiguous right to participate in SRAs conducted by NEMMCO under the NER.⁵ The 2006 Rule (a Participant Derogation) exempts EA as a TNSP from the effect of clause 3.18.2(g)(2) of the Rules. Clause 3.18.2(g)(2) prevents TNSPs from entering into settlement residue distribution agreements and, effectively, auction participation agreements. In making the Participant Derogation, the Commission provided that the derogation would expire on the earliest of five separate conditions occurring, one of which was 30 June 2009.⁶

1.3 Proponent's Proposed Solution

EA requests that the existing Participant Derogation be extended to 30 June 2012, either by way of an extension to the existing derogation or by the approval of a new one which is identical in content, to enable EA to continue to have an unambiguous right to participate in the SRA process.⁷

1.4 Consultation

On 30 April 2009, the Commission published a notice under section 95 of the NEL advising of its intention to commence the Rule change process and initial consultation on the 2009 Rule Change Proposal.

The Commission accepted that the 2009 Rule Change Proposal was a request for a non-controversial rule as it considered that the proposed Rule would be unlikely to have a significant effect on the NEM because it proposed to extend existing arrangements which, to date, have been supported. Accordingly, the Commission intended to expedite the 2009 Rule Change Proposal under section 96 of the NEL, subject to any written objections. On 15 May 2009, the deadline for written objections closed. None were received. Accordingly, the 2009 Rule Change Proposal was considered under an expedited process under section 96 of the NEL.

On 28 May 2009, the submissions period for the 2009 Rule Change Proposal closed. The Commission received one submission from NEMMCO which was supportive of the proposed extension of the Participant Derogation.

⁵ 2006 Rule Change Proposal.

⁶ AEMC 2006, *EnergyAustralia Participant Derogation (Settlement Residue Auctions)*, Rule Determination, 16 June 2006 Sydney, p7(2006 Determination). The Commission's reasoning is explained in more detail in chapter 3. The other conditions are the date that: (a) EA's retail business is transferred to another entity, (b) EA ceases to own, control or operate a transmission system, (c) NEMMCO determines that EA's transmission system is capable of having a material impact on interconnector capability, and (d) that EA is not excluded from entering into settlement residue distribution agreement.

⁷ 2009 Rule Change Proposal, p.2.

2 Rule Determination

2.1 Commission's Determination

In accordance with section 102 of the NEL the Commission has made and published this Rule determination. In accordance with section 103 of the NEL the Commission has made the *National Electricity Amendment (EnergyAustralia Participant Derogation Extension (Settlement Residue Auctions)) Rule 2009 (Rule as Made)*.

The Rule as Made will commence on 1 July 2009.

The Rule as Made is published with this Rule determination.

2.2 Commission's Considerations

This Rule determination sets out the Commission's reasons for making the Rule as Made. In coming to its decision, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule as Made;
- the 2009 Rule Change Proposal and the proposed Rule;
- submissions on the proposed Rule;
- the 2006 Rule Change Proposal;
- the 2006 Rule and 2006 Determination;
- relevant Ministerial Council on Energy (MCE) statements of policy principles;⁸ and
- the Commission's analysis as to the ways in which the 2009 Rule Change Proposal will, or is likely to, contribute to the National Electricity Objective (NEO) so that the Rule making test is satisfied.

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO. The Rule as Made satisfies the Rule making test because:

- EA's participation in the SRA market will increase the level of competition for SRA units in general, which will improve the potential for efficient price outcomes from the SRA market, and support greater efficiency in the overall market for financial hedge instruments. This leads to benefits for end users in the NEM through more efficient energy market prices; and

⁸ There are no relevant MCE statements of policy principles for this Rule change request.

- end users are likely to benefit from more efficient auction outcomes where auction proceeds are passed through to end users as an offset to network use of system charges.

The Commission accepts that EA's current ownership of transmission assets will not directly enable EA to manipulate or distort the accumulation of settlement residues. Ownership of the transmission assets should therefore, of itself, not be an impediment to participation of EA in the SRA process.

2.3 Commission's power to make the Rule

The Commission is satisfied that the Rule as Made falls within the subject matters for which the Commission may make Rules as set out in section 34 of the NEL and in Schedule 1 to the NEL. The proposed Rule is within:

- the matters set out in section 34(3)(1)(ii), as it relates to providing a registered participant with an exemption from complying with a provision of the Rules; and
- the matters set out in item 34(a) of Schedule 1 of the NEL as it relates to the payment of money for the settlement of transactions for electricity purchased or supplied through the wholesale exchange operated and administered by NEMMCO.

3 Commission's Assessment against NEL Criteria

This Chapter sets out the Commission's assessment of the 2009 Rule Change Proposal and its reasons for making the Rule as Made.

3.1 Methodology

In assessing any proposed Rule change against the NEL criteria, the counterfactual arrangements against which the Rule change is being compared in light of the NEO must be considered. In the present case, the relevant counterfactual would be EA not having a Participant Derogation, and therefore not having an unambiguous right to participate in SRAs conducted by NEMMCO under the NER after 30 June 2009.

3.2 Rule making test and the National Electricity Objective

The Rule making test states that the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO.⁹ The objective of the NEL 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:

- price, quality, safety, reliability and security of supply of electricity; and
- the reliability, safety and security of the national electricity system.¹⁰

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic dimensions of efficiency), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

3.3 Background

Of relevance to the Commission's consideration of the 2009 Rule Change Proposal are the 2006 Rule Change Proposal and 2006 Determination. The key points are outlined below.

3.3.1 EA's participation in SRAs

EA operates an electricity distribution and energy retail business. In 2000 part of EA's distribution infrastructure was reclassified as transmission infrastructure. Consequently from 2000 onwards EA has been registered as a TNSP under the NER.

⁹ See section 88(1) of the NEL

¹⁰ See section 7 of the NEL

As a retailer in the NEM, EA executed an auction participation agreement with NEMMCO and commenced participating in SRAs in March 2001.¹¹

Prior to 1 July 2005 NEMMCO had discretion as to whether TNSPs were able to enter into settlement residue distribution agreements. However on 1 July 2005 clause 3.18.2(g)(2) of the NER was amended to prohibit TNSPs from entering into settlement residue distribution agreements with NEMMCO. This amendment effectively excluded EA from participating in SRAs.

The policy rationale for NEMMCO being able to exclude TNSPs from SRAs was to exclude the entities which owned assets that could be used to manipulate the value of the settlements residue.¹²

3.3.2 Original request for a participant derogation - 2006

On 18 April 2006 the Commission received the 2006 Rule Change Proposal. The 2006 Rule Change Proposal sought a participant derogation in relation to clause 3.18.2(g)(2) of the NER.¹³

EA and NEMMCO's arguments in the 2006 Change Proposal were as follows:

- Clause 3.18.2(g)(2) of the NER excludes TNSPs (hence EA) from participating in SRAs conducted by NEMMCO.¹⁴ EA's ability to participate in SRAs forms an important component of its spot market risk minimisation strategy, contributing to its competitiveness and maximising the potential value delivered to its customers.¹⁵
- The policy rationale for excluding TNSPs from SRAs was to exclude entities which owned assets that could be used to manipulate the value of the settlements residue.¹⁶
- Due to the nature of its transmission system EA stated that it could not have any material impact on the value of the settlements residue.¹⁷

¹¹ 2006 Rule Change Proposal, p.7. As noted by EA in the 2009 Rule Change Proposal, participation in SRAs provides market participants with access to 'units' of settlement residue on the various interconnectors in the NEM, providing retailers with access to the full range of potential hedging transactions to reduce the significant financial risk borne by trading in the NEM.

¹² ACCC 1999, *Final Determination: Applications for Authorisation, National Electricity Code, Settlements Residue Auction Process*, 22 December 1999, A90688, A90689 and A90690. (ACCC Final Determination). The ACCC Final Determination authorised the introduction of clause 3.18.2(g)(2) into the then National Electricity Code.

¹³ NEMMCO and EnergyAustralia 2006, *Request for Participant Derogation to the National Electricity Rules re EnergyAustralia's participation in Settlement Residue Auctions*, 13 April 2006, p.2.

¹⁴ 2006 Rule Change Proposal, p.4.

¹⁵ 2006 Rule Change Proposal, p.8.

¹⁶ 2006 Rule Change Proposal, p.4.

¹⁷ 2006 Rule Change Proposal, p.8.

3.3.2.1 Hedging instruments contribute to EA's efficiency

As the largest electricity retailer in NSW, EA submitted that it was important that it has access to the full range of potential hedging transactions to reduce the significant financial risks borne by retailers trading in the NEM.¹⁸ These hedging instruments contribute to EA's efficiency and competitiveness as a retailer, and to maximises value for its retail customers.¹⁹

In EA's view, competitive neutrality and the interests of its customers required that EA have the same access to SRAs as other retailers with whom it competes.

3.3.2.2 Ability of EA's transmission network to effect settlements residue

As stated above, the rationale for NEMMCO being able to exclude TNSPs from SRAs was to exclude the entities which owned assets that could be used to manipulate the value of the settlements residue.²⁰

In the 2006 Rule Change Proposal EA advised and NEMMCO confirmed that most of EA's classified transmission network:

- is contained within its distribution district and is a long way from the boundary between the NSW region and the other regions; and
- runs parallel to TransGrid's network and essentially serves as a back-up to TransGrid's network.²¹

EA submitted that the location and role of its transmission system meant that it could not operate its transmission system in a way that would have any material impact on the value of the settlements residue. The intent of clause 3.18.2(g)(2) of the Rules would not be served by preventing EA from participating in SRAs.

EA also submitted that the switching of its transmission system did not have any material impact on spot market outcomes. Generators would continue to be dispatched according to the NER and could not be materially constrained off by EA.²²

To ensure that it could not materially effect the SRA process, the 2006 Rule Change Proposal proposed that the Participant Derogation would cease to apply if EA became capable of influencing settlements residues. In particular, the Participant Derogation was to expire upon EA engaging in the activity of owning, controlling or operating a transmission system that NEMMCO determines (in accordance with criteria developed pursuant to clause 5.6.3(i) of the NER), is capable of having a

¹⁸ 2006 Rule Change Proposal, p.8.

¹⁹ 2006 Rule Change Proposal, p.11.

²⁰ ACCC, *Final Determination: Applications for Authorisation, National Electricity Code, Settlements Residue Auction Process*, 22 December 1999, A90688, A90689 and A90690.

²¹ 2006 Rule Change Proposal, p.8.

²² 2006 Rule Change Proposal, p.8.

material impact by reducing the interconnector capability and thus impacting the settlement residue.²³

3.3.3 2006 Rule determination

On 16 June 2006 the Commission made the 2006 Rule, being a participant derogation providing EA with the unambiguous right to participate in SRAs conducted by NEMMCO under the NER. The 2006 Rule provided that the derogation would expire on the earliest of five separate conditions occurring, one of which was 30 June 2009.

In the 2006 Determination the Commission outlined the following arguments in support of the proposed Rule meeting the Rule making test.

“The SRA process is intended to facilitate NEM participants entering into financial contract positions with counterparties in other NEM regions. Such inter-regional trading is an important element of the NEM design, because it increases the level of competition for financial risk management instruments, which in turn places pressure on the price of risk management towards underlying costs.

The Commission is of the view that EnergyAustralia’s participation in the SRA market will increase the number of contract counterparties available to EnergyAustralia, and will also increase the level of competition for SRA units in general. The increased competition will improve the potential for efficient price outcomes from the SRA market, and ultimately supports greater efficiency in the overall market for financial hedge instruments. This leads to benefits for end users in the NEM through more efficient energy market prices.

End users are also likely to benefit from more efficient auction outcomes where auction proceeds are passed through to end users as an offset to network use of system charges.

The Commission accepts that EnergyAustralia’s current ownership of transmission assets will not directly enable EnergyAustralia to manipulate or distort the accumulation of settlement residues. Ownership of the transmission assets should therefore, of itself, not be an impediment to participation of EnergyAustralia in the SRA process.

The Commission is therefore satisfied that it is in the long term interest of electricity consumers, and that it will contribute to the achievement of the

²³ The criteria that have been determined by the IRPC are published on NEMMCO’s website at: <http://www.nemmco.com.au/psplanning/170-0035.pdf>

national electricity market objective, for this participant derogation to be made, allowing EnergyAustralia to participate in the SRA process.”²⁴

3.4 Request for an extension to participant derogation - 2009

On 30 March 2009 the Commission received the 2009 Rule Change Proposal requesting an extension of the expiry date of the 2006 Rule by three years to 30 June 2012.²⁵ EA submits that any continued participation would not have any adverse impact on the operation of the SRAs because:

- the previous circumstances relating to EA’s inability to participate in SRAs remain unchanged as there have been no amendments made to either the NER or the Auction Rules that would otherwise facilitate participation without a derogation; and
- their participation in SRAs to date has not had any adverse impact on the operation of the SRAs.²⁶

3.4.1 Submissions

One submission was received from NEMMCO during the consultation period for this Rule change request.

The submission noted that in 2006 NEMMCO and EA jointly proposed the existing Participant Derogation on the basis that EA’s transmission assets were an incidental part of its business as a retailer and distributor and unlikely to have a material impact on inter-regional settlement residue (IRSR) values.

NEMMCO states that it is not aware of any changes to EA’s transmission assets or business activities that would allow it to have a material impact on IRSR values in the NEM. Consequently, NEMMCO supports EA’s Rule change proposal.

3.4.2 Comment

The Commission has not identified, or had brought to its attention, any circumstances that it regards materially changes the circumstances from, or the conclusions reached in respect of, the initial Rule change process conducted in 2006.

In particular, none of the other conditions that would result in the expiry of the derogation have occurred.

The Commission understands that there have been no changes to EA’s transmission assets that would affect the SRA process. NEMMCO’s submission

²⁴ 2006 Determination, p. 6-7.

²⁵ 2009 Rule Change Proposal, p.2

²⁶ 2009 Rule Change Proposal, p.5

confirms this and, in this regard, NEMMCO supports the 2009 Rule change Proposal. The reasoning contained in the 2006 Determination accepted that:

- EA's involvement would improve the potential for efficient price outcomes from the SRA market, and support greater efficiency in the overall market for financial hedge instruments; and
- the location and operational function of EA's transmission assets would not directly enable it, in its role as a TNSP, to manipulate or distort the accumulation of settlement residues.

This reasoning is still applicable.

3.5 Assessment against Rule making test

The Commission has analysed and assessed the 2009 Rule Change Proposal. The Commission considers that, until such time as this issue is resolved on a long term basis, either through a change in the NER or a restructure of EA, a participant derogation allowing EA an unambiguous right to participate in SRAs is required.

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO. The Commission believes the arguments made in the 2006 Rule Determination are still current and applicable.²⁷ The Rule as Made satisfies the Rule making test based on the following:

- EA's participation in the SRA market will increase the level of competition for SRA units in general, which will improve the potential for efficient price outcomes from the SRA market, and support greater efficiency in the overall market for financial hedge instruments. This leads to benefits for end users in the NEM through more efficient energy market prices; and
- end users are likely to benefit from more efficient auction outcomes where auction proceeds are passed through to end users as an offset to network use of system charges.

The Commission accepts that EA's current ownership of transmission assets will not directly enable EA to manipulate or distort the accumulation of settlement residues. Ownership of the transmission assets should therefore, of itself, not be an impediment to participation of EA in the SRA process.

²⁷ 2006 Determination, p.7