

## Australian Energy Market Commission

### Rule Determination

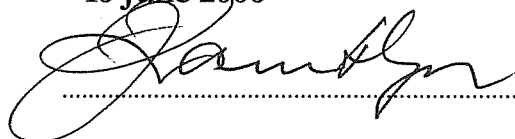
National Electricity Amendment (Energy Australia Participant Derogation (Settlement Residue Auctions)) Rule 2006

**Rule Proposal:** Request for participant Derogation to the National Electricity Rules re: EnergyAustralia's participation in Settlement Residue Auctions

**Proponent:** EnergyAustralia and National Electricity Market Management Company ("NEMMCO")

**Date:** 16 June 2006

**Signed:**



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John Tamblyn  
Chairman

For and on behalf of:  
Australian Energy Market Commission

Commissioners: Tamblyn  
Carver  
Woodward

# Summary

EnergyAustralia (EA) and NEMMCO have submitted a joint proposal for a participant derogation that includes EA within the category of an “eligible person” under clause 3.18 of the National Electricity Rules (the Rules), despite EA being a Transmission Network Service Provider (TNSP). Presently under the National Electricity Rules (the Rules) NEMMCO is not permitted to allow TNSP’s to participate in the Settlement Residue Auction (SRA) process as a result of clause 3.18.2(g).

EA and NEMMCO have also requested that the Australian Energy Market Commission (the Commission) consider this Rule proposal as non-controversial and therefore progress it under an expedited Rule change process pursuant to section 96 of the National Electricity Law (NEL).

On 11 May 2006 the Commission gave notice of its decision to consult on this proposal under sections 95 and 96 of the NEL and its intention to treat this Rule proposal as non-controversial under section 96 of the NEL, subject to the Commission receiving any objections.

The Commission received one submission on the proposed participant derogation from Snowy Hydro Limited (Snowy Hydro) which supported the proposal.

The Commission now makes this final Rule determination on EA and NEMMCO’s Rule proposal. The Commission has determined to make the derogation and has substantially accepted the proponents’ Rule proposal, but has made some amendments to the wording of the proposed Rule as discussed in the body of this determination in order to improve the effectiveness of the derogation.

## The Proponent’s Rule Proposal

In their proposal, EA and NEMMCO set out the background that forms the basis for their request for a derogation and the key points of this proposal are noted below.

EA operates an electricity distribution business, and energy retail business in the National Electricity Market (NEM). Part of EA’s distribution infrastructure however, has been classified as transmission infrastructure. EA is therefore a registered TNSP under the Rules.

Initially a jurisdictional derogation to the National Electricity Code provided that EA’s network and connection assets would be treated as a distribution system until 2000. From 2000 to 2001, the network and associated connection assets became regulated as a transmission system.

As a retailer in the NEM, EA executed an auction participation agreement with NEMMCO and commenced participating in settlement residue auctions in March 2001.

On 1 July 2005, clause 3.18.2(g)(2) of the Rules was amended to prohibit TNSP's from entering into settlement residue distribution agreements (SRDs) with NEMMCO. Prior to this amendment NEMMCO had discretion under the Rules as to whether TNSP's were able to enter into these agreements. SRDs provide market participants with access to units of settlement residue on the various NEM interconnectors, and are the means by which NEMMCO implements the result of the SRAs.

The SRA process provides NEM participants with potential to reduce the significant financial risks of trading across region boundaries. The ability to enter into SRDs with NEMMCO forms an important component of EA's spot market risk minimisation strategy.

EA and NEMMCO seek a participant derogation to the Rules to ensure that EA is eligible to participate in SRAs and to enter into SRD agreements with NEMMCO.

NEMMCO and EA have also requested that the Commission determine this matter to be non-controversial and be subject to an expedited Rule making process pursuant to section 96 of the NEL, setting out the following reasons in the Rule proposal:

- (a) *"...it is clear from the Australian Competition and Consumer Commission's ("ACCC's") final determination authorizing the introduction of clause 3.18.2(g) to the national Electricity Code that the rationale for excluding TNSP's from settlement residue auctions was to exclude the entities which owned assets which could be used to manipulate the value of the settlements residue. There is no rationale to exclude EnergyAustralia because it does not own assets which have any material impact on the size of the settlements residue..."; (p. 4)*
- (b) *"...the competitive neutrality that the Rules attempt to achieve requires that a retailer such as EnergyAustralia should have access to the same hedging products as retailers against whom it competes and therefore should be allowed to participate in the settlement residue auction..."; (p. 4)*
- (c) *"...excluding EnergyAustralia does nothing to promote the objectives of the provisions in the Rules and disadvantages both EnergyAustralia and its customers..." (p. 4)*
- (d) *"...EnergyAustralia has participated in settlement residue auctions from March 2001 until recently (when the problem with the wording in the Rules and the Auction Rules was identified. Following the identification of the problem:*
  - a. *The AER has written to both NEMMCO and EnergyAustralia expressing the view that the current "ambiguity and uncertainty" under the Rules and the Auction Rules with respect to EnergyAustralia's right to enter into SRD's must be rectified "as soon as possible.*
  - b. *EnergyAustralia has provided an undertaking to the AER not to participate in settlement residue auctions until such time as sufficient amendments have been made to one or both (as necessary) of the Rules and Auction Rules to unambiguously permit EnergyAustralia to participate in such auctions." (p. 5)*

NEMMCO proposes to amend the Auction Rules in accordance with the procedure in the Rules to ensure the Auction Rules are consistent with the National Electricity Rules as amended by the participant derogation in relation to EA. NEMMCO and EA also propose to consider whether any changes to the terms of their auction participation agreement are necessary and to make any changes which are required.

## **Rule determination**

On 9 May 2006, the Commission determined (in response to EA and NEMMCO's request) to consult on this participant derogation proposal under section 96 of the NEL as a non-controversial Rule change which permitted an expedited process subject to receiving and considering any objections from stakeholders.

### ***Consultation process and submissions***

The expedited process set out in section 96 of the NEL involved a consultation framework consisting of:

- a) a 2 week period commencing from 11 May 2006 for submissions by way of objection to the expedited process; and
- b) a 4 week consultation period commencing from the same date for interested persons to make submissions in relation to the proposed Rule change itself.

The Commission did not receive any objections either in respect of the substance of the participant derogation proposal, or in respect of the matter proceeding to determination under the expedited Rule change process.

The Commission received one submission from Snowy Hydro Limited which supported the Rule proposal. In its submission, Snowy Hydro stated it believed that the Commission should approve the derogation on the following grounds:

- That the fact that EA is considered a TNSP under SRA process is purely a classification issue and EA's transmission assets, in the view of Snowy Hydro Limited, will have no material impact on the quantum of settlement residues that will accrue;
- That the SRA units are an important tool for inter-regional hedging and the exclusion of EA from participation in the SRA process is not competitively neutral.

Given the outcome of the consultation process, the Commission has determined:

- a) to expedite the making of this Rule under section 96 of the NEL, and accordingly makes this final Rule Determination under section 102 of the NEL without a second round of consultation or a draft determination under section 99 of the NEL(s.96(1));
- b) to make the participant derogation proposed by EA and NEMMCO for the reasons set out in the "Additional matters arising from consultation and the Commission's

analysis” and “Assessment of the Rule: the Rule making test and the national electricity market objective” Sections of this Rule determination; and

- c) in accordance with section 103 of the NEL to make the Rule. (The Rule to be made (the Rule) is attached to this determination).

This determination sets out the Commission’s reasons for making the Rule. The Commission has taken into account:

1. The Commission’s powers under the NEL to make the Rule;
2. The proponent’s Rule change proposal and proposed Rule;
3. The submission received (and noted above);
4. Whether there are any relevant Ministerial Council of Energy (“MCE”) statements of policy principles;
5. The Commission’s analysis as to the way(s) in which the Rule will or is likely to contribute to the achievement of the national electricity market objective in accordance with the statutory Rule making test.

### ***The Commission’s power to make the Rule***

The subject matters about which the Commission may make Rules are set out in a general way in section 34(1) of the NEL and more specifically, in s.34(2),(3) and Schedule 1 to the NEL.

The proposed participant derogation is within the matters set out in sections 34(1) and 34(3)(l) and (m), as it relates to providing NEMMCO and a Registered Participant with an exemption from complying with a provision of the Rules or otherwise modifies the application of clause 3.18.2(g) to EA.

The Commission is satisfied that the proposed participant derogation is a matter about which the Commission may make a Rule.

### ***Additional matters arising from consultation and the Commission’s analysis***

EA submits that the rationale for prohibiting TNSPs from participating in SRAs, is to exclude the entities which own assets that could be used to manipulate the value of the settlements residue. EA quotes the ACCC’s final determination authorising the prohibition of TNSP’s from participating in SRA’s as follows:

*“TNSP’s have the ability to directly influence the constraints applying to interconnectors and thus the volume of electricity dispatched through an interconnector at a particular time this will directly impact on the residue outcome.”* (p. 9)

EA has submitted that although it is a TNSP, it is not able to manipulate the SRA process. Firstly, EA submit and NEMMCO confirm that its transmission assets are geographically remote from the boundary between the New South Wales Region and the other NEM regions. Furthermore EA submits that its 132kV network runs in parallel to TransGrid's network and essentially serves as a backup to TransGrid's network. Thirdly, EA submits that it does not have any assets which operate at or above 220kV.

EA therefore states that the switching of its transmission system does not have any material impact on spot market outcomes and EA is not aware that any of the elements of its transmission system form part of the constraint envelope used by NEMMCO in dispatch calculations.

The joint proposal submitted by EA and NEMMCO states that NEMMCO confirms that its analysis supports EA's submission that EA's transmission system cannot materially impact on spot market outcomes and does not form a material part of NEMMCO's constraint envelope.

Similarly, Snowy Hydro Limited in its submission also agreed with the position that EA's transmission assets will not have a material impact on the outcomes of the SRA process.

The Commission notes that the location and operational function of EA's transmission assets are remote from any regional boundary and broadly accepts that those assets would not enable EA to manipulate the SRA process in its role as a TNSP.

On this basis, the Commission considers that the derogation should be made. The derogation proposed by EA and NEMMCO exempts EA as a TNSP from the effect of clause 3.18.2(g)(2). Clause 3.18.2(g)(2) prevents TNSP's from being an eligible person for the purposes of SRD agreements. Eligible persons are defined in clause 3.18.2(b) and (g) and only eligible persons may enter into SRD agreements with NEMMCO, (as per clause 3.18.1) and only eligible persons may enter into an auction participation agreement.

The Commission has made one material amendment to the proposed Rule which relates to the following paragraph in the Rule proposal:

*“(c) Subject to paragraph (d) below, any SRD agreement validly entered into between NEMMCO and EnergyAustralia during the derogation period in accordance with the Rules (as amended by this participant derogation) will remain binding and capable of being performed despite the expiry of the participant derogation prior to the completion of the exercise of all rights and the performance of all obligations under that SRD agreement.”*

The Commission has removed the above paragraph from the Rule to be made (i.e. the derogation) as the Commission is of the view that the paragraph is both ineffective and unnecessary. During the period of the derogation, EA will be considered an eligible person and will be able to enter into SRD agreements. Accordingly, all SRD agreements entered into between EA and NEMMCO during the period of the derogation will be valid SRD agreements for the purpose of the Rules. Further, once the derogation expires, it cannot form a basis for the continuing validity of the SRD agreements. There is therefore no need or capacity to preserve such SRD agreements after the derogation expires.

In addition, the derogation will have the effect of allowing EA to enter into auction participation agreements (as defined in clause 3.18.1) with NEMMCO. Auction participation

agreements are another component of the SRA process and the Rules similarly require EA to be an eligible person to enter into this agreement (similar to the SRD agreement) with NEMMCO.

The Commission has also made some minor amendments to the Rule proposed by the proponents to maintain consistency with the other derogations in Chapter 8A and to enhance the ease of understanding of the Rule to be made.

### ***Assessment of the Rule: the Rule making test and the national electricity market objective***

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

# **Attachment 1: Rule to be made**