

16 December 2016

Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney, NSW, 2000**Rule Change Proposal: Facilitation of Secondary Trading of Settlement Residue Distribution Units through the Settlement Residue Auction**

A minor change to the National Electricity Rules (NER) is proposed that would enable AEMO and the Settlement Residue Committee (SRC) to consider implementing secondary trading for Settlement Residue Distribution Agreement (SRDA) units through the Settlement Residue Auction (SRA).

In response to a proposal from Westpac, the SRC has expressed interest in facilitating secondary trading of SRDA units through the SRA. The proposed changes could mostly be enacted by changes to the auction rules, which are administered by the SRC. However, the change being contemplated would also require some amendments to the NER. Westpac is seeking to make the required NER amendments now, to enable the SRC to complete progress to a public consultation on the auction rule changes.

The proposed NER change will not change the SRC's role in maintaining the Auction Rules and does not circumvent the need for the SRC to conduct a public consultation on suggested changes to the Auction Rules. For reference, the case for a change to Auction rules as presented to the SRC is contained in Appendix 1.

For the avoidance of doubt, the proposed NER change will not mandate any change to the current Auction Rules. If the NER change is made, the option will remain open for the SRC, and the broader market through consultation, to consider and potentially reject any change to the Auction Rules.

Westpac acknowledges and thanks AEMO for their technical assistance in preparing this rule change proposal.

About Westpac

Westpac is a major supporter of Australia's electricity sector and market participants. Westpac supports its customers not only as a credit provider to electricity retailers and wholesale electricity providers, but also through the provision of a broader range of products and services.

Key amongst these additional products and services is Westpac's role as the largest and oldest financial intermediary in the wholesale electricity market. Westpac is a key market maker and liquidity provider in both the exchange traded and over the counter markets, a service which feedback clearly indicates is highly valued by our direct customer base and other market participants to enable them to manage the price risks associated with their core business.

Background on SRDA units

Interconnectors between regions of the NEM generally transport power from a low-priced region to a higher priced region, creating settlement residue. Rights to a share of this settlement residue are auctioned to NEM participants on a quarterly basis for each directional interconnector and for each of the next 12 quarters. Each right is referred to as a SRDA unit and is subject to a Settlement Residue Distribution Agreement (SRDA) between AEMO and the NEM participant in accordance with the National Electricity Rules (NER).

The purpose of auctioning SRDA units is to provide an additional hedging tool for participants wishing to manage inter-regional price risk. Inter-regional hedges help to allow generators and retailers in different regions to compete effectively and for trader class participants to offer hedges in the market.

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Under the NER, an SRDA unit is a financial contract between a NEM participant and AEMO. However, NEM participants can also enter into standardised financial contracts that exactly match the payoff structure of an AEMO-issued SRDA unit with counter-parties other than AEMO. These contracts are also referred to as SRDA units (or SRA units) by financial market participants. SRDA units not issued by AEMO do not form any part of the Settlement Residue Auction run by AEMO.

Although SRDA units are auctioned up to three years in advance of the quarter to which they apply, actual settlement only occurs in the relevant quarter. When making a bid at an auction, an auction participant is legally committing to settling the unit at that price in the future.

A NEM participant that has been allocated AEMO-issued SRDA units may assign those units to another NEM participant with both AEMO's consent and the transferee's acceptance. The transferee must meet all eligibility criteria (SRA rule 3.2) to participate in the SRA Auction and must have executed an Auction Participation Agreement with AEMO. The SRDA transfer process was developed in consultation with the SRC and is intended to support secondary trading of the units. However, this bilateral secondary market has not achieved the liquidity and depth that exists in the primary auction.

The Role of the SRC and Auction Rules

Clause 3.18 of the NER sets out SRA concepts, eligibility, and distribution of proceeds and fees. It requires AEMO to convene the SRC with specified powers, and to develop auction rules.

The auction rules define the auction procedure, timetable, bidding, fees, and the contractual instrument between AEMO and the successful bidder. These rules will require a major amendment to facilitate secondary trading within the auction. NER 3.18.3 (d) and (e) states that AEMO may amend the auction rules in the following steps:

- with the approval of the SRC *and*
- public consultation in accordance with the NER consultation procedures.

The SRC is chaired by AEMO, and includes representatives of market participants, TNSPs, jurisdictions, and retail customers. This group is well qualified to consider the merits of secondary trading within the auction. In addition, the public consultation process enables parties not directly represented in the SRC to contribute.

The cost of running the SRA is recovered from SRA participants only, i.e. it is separated from AEMO's participant fees. Thus only auction participants will fund the costs of enhancing the auction and their interests are well represented in the SRC and in AEMO's consultation process.

The SRC has previously overseen a number of significant reforms to the Auction, such as:

- The extension of forward vintages from 1 year to 3 years.
- The abolition of the Snowy region.
- Changes to unit pool sizes

They are well qualified to investigate the merits of, and if supported, implement, changes to the auction to facilitate secondary trading.

Statement of Issue

Westpac and the South Australian government have each separately recommended that the SRC facilitate the secondary trading of SRDA units by enabling previously allocated units to be cancelled and made available in the SRDA pool at an auction. The SRC expressed support for AEMO to investigate the development in detail, which was reported back to the SRC.

AEMO's report contemplated the implementation, legal and prudential matters. The matters are largely within the SRC's powers to consider and progress.

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However AEMO identified that: “A change to the National Electricity Rules would be required to allow for secondary sales, including to allow for the distribution of proceeds from the secondary auction to the seller of the secondary unit.”

NER 3.18.4(a) requires that AEMO must distribute proceeds from each auction to the appropriate Network Service Providers (NSPs). NER 3.18.4(a) is inconsistent with sellers of SRDA units receiving a portion of auction proceeds and therefore prevents the Auction Rules contemplating secondary trading of SRDA units at auction.

NER 3.18.4(a) was drafted in the early years of the NEM to ensure that the proceeds of AEMO’s release of primary SRDA units were transferred to NSPs. The secondary trading proposal will not alter this outcome. Whilst the original drafters did not anticipate this future enhancement of the auction, they would not have intended to obstruct it, and so this feature of the NER appears unintentional.

Proposed solution

The primary purpose of the proposed NER change seeks to remove the unintended prohibition of secondary trading in the NER.

Whilst the NER change proposal is intended to empower the SRC to implement the secondary trading proposal, it does not mandate its implementation. As per the governance of the auction laid out in 3.18.3, the decision to implement any auction rule changes remains with the SRC.

Description of the proposed Rule

AEMO has assisted Westpac by preparing some NER drafting that would best facilitate secondary trading. Specific changes to the NER are listed in Appendix 2 and explained in Appendix 3.

The proposed NER changes have been drafted on the basis that AEMO will pay to cancel the SRDA units of the original unitholder, and independently of that transaction, AEMO may make the settlement residue available in another auction and enter into a new SRDA with a new holder of equivalent units. AEMO would recover the amounts paid to cancel SRDA units from the proceeds of auctions.

The proposed structure is intended to be consistent with the existing Australian Securities and Investments Commission (ASIC) relief from financial service regulations granted to AEMO. Secondary trading, if pursued, will maintain the existing auction mechanism. Transactions between the seller and buyer of SRDA units will be intermediated by AEMO and AEMO will remain a counterpart to all SRDAs.

The proposed NER changes address the following matters:

- Recognise that eligible persons may offer back SRDAs to AEMO.
- AEMO will pay for any SRDAs offered back and those SRDAs will be cancelled.
- AEMO may offer the settlement residue associated with cancelled SRDAs in another auction.
- Empowers AEMO to recover amounts paid to eligible persons for SRDAs offered back from the proceeds of auctions, rather than all proceeds being distributed solely to Network Service Providers.
- Clarifies that if AEMO incurs a shortfall after recovering costs from the proceeds of auctions, then recovery of the shortfall would align with the distribution of surpluses and recovery of negative settlement residue, i.e. it resides with the relevant Network Service Provider.

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National Energy Objective

The National Electricity Objective (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, safety, reliability and security of supply of electricity; and*
- b) the reliability, safety and security of the national electricity system.*

Westpac believes that the National Energy Rules already recognize that efficiency in the settlements residue market contributes to the NEO as National Energy Rule 3.18.3(b) states:

In developing and amending the auction rules, AEMO must give effect to the following principles:

- (1) [Deleted]*
- (2) to the extent reasonably practicable, an auction must be structured in a way that maximises the value of the relevant settlements residue;*
- (3) the price for each unit of the settlements residue in respect of a directional interconnector will be the same for all SRD agreements resulting from the same auction and will be equal to the auction clearing price in respect of the directional interconnector for the auction; and*
- (4) enhancing competition and efficiency by promoting interstate trade in electricity.*

If made, the Rule change will permit the appropriate decision makers, being the SRC and AEMO, to consider via public consultation, facilitating secondary trading through the auction in ways that furthers the NEO:

- Principle (4) above aligns with the long-term interest of consumers with respect to price in the supply of electricity.
- Section 49 (3) of the National Electricity Law obliges AEMO to have regard to the NEO when carrying out its statutory functions, such as developing the SRA Auction Rules.
- The SRC will also consider the benefits it creates for SRA users versus the costs of implementation, which will be funded, through auction fees, by SRA users. This contemplation parallels the test of the long-term interest of consumers with respect to price.

Costs, Benefits and Potential impacts

The cost of the proposed NER change is effectively nil, as the amendment serves only to empower the SRC's contemplation of enhancing the Auction.

The costs and benefits of facilitating secondary trading will be dealt with by the SRC and by AEMO through consultation on the Auction Rules, which is obliged to occur following this NER change. Nevertheless, appendix 1 includes an explanation of the costs and benefits in order to assist understanding of the matters that will be considered at that stage.

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Summary

The core of the proposed auction rule change is to allow the SRC to consider the sale of secondary SRDA units at SRAs.

The proposed rule change would enable AEMO to distribute the relevant portion of the auction proceeds to the sellers of SRDA units, which is not currently consistent with rule 3.18.4(a).

The NER already recognise that promoting interstate trade of electricity and maximising the value of settlements residue enhances the National Energy Objective. The rule change has the potential to contribute to interstate trade and increase the value of SRDA units to the market as a whole.

Implementation of the proposal would utilise the existing auction legal framework, processes and systems and as such could be achieved at a relatively low cost. The implementation costs would be borne by market participants who value the liquidity of the settlement auctions.

Yours Sincerely,

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Appendix 1 – Costs and benefits

If Westpac's NER change is approved, the SRC will be empowered to redesign the auction to facilitate secondary trading through it, and to consider its costs and benefits. The costs and benefits that will be considered at that stage are outlined in this section for context.

Proposed changes to AEMO's Settlements Residue Auction

Westpac proposes that owners of SRDA units issued by AEMO be allowed to offer those units for re-sale at the Settlement Residue Auctions run by AEMO every quarter.

It is not proposed that participants should be able to short SRDA units. Only AEMO-issued SRDA units purchased in a previous auction may be sold.

AEMO would enhance the SRA to facilitate simultaneous secondary trading with the release of primary units.

Participants would submit bids for SRDA units as normal. Participants could also submit offers for sale in an analogous process to the submission of bids. AEMO would implement a restriction on bids and offers such that participants' highest bid must be less than their lowest offer in any SRDA unit.

If any SRDA units are successfully sold at auction, AEMO would cancel the SRDA units with the seller and issue new SRDA units to the buyer. In this way, there would be no difference between a primary and secondary SRDA unit and the counter-party to an SRDA unit purchased at auction would always be AEMO.

AEMO would not transfer sale proceeds to the seller until the relevant settlement date for the SRDA unit sold. To be clear, it is intended the settlement date for SRDA units sold is the same as the settlement date for SRDA units bought.

AEMO should charge auction fees to both buyers and sellers of SRDA units. Any increased cost of developing or running sales at auction should be recovered from increased auction fees at future auctions.

Initial consideration by AEMO and the Settlements Residue Committee

Westpac's proposal to change the Settlements residue auction to allow sale of secondary SRDA units was presented to AEMO and the Settlements Residue Committee.

AEMO has advised that:

- The proposed changes could technically be incorporated into the auction mechanism
- A change to at least NER 3.18.4(a) would be required
- The proposed system and procedure changes had an estimated cost of \$195-285k
- It would seek confirmation from Australian Securities and Investment Corporation (ASIC) that the change can be achieved within existing financial service regulation exemptions.

The Settlements Residue Committee agreed that a NER change should be progressed, led by Westpac.

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Statement of Issue

1. Lack of Liquidity

Westpac estimates that the volume of SRDA units traded outside an SRA Auction is less than 1% of the volume of primary SRDA units bought at auction. Westpac has been operating in the electricity market since 2002 and prior to that holds records of SRDA trades conducted by Enron since market start. Throughout this period we have had the ability to trade with most of the major physical participants in the NEM and have actively quoted prices for all standard electricity hedge contracts including SRDA units. Westpac's history and activity in the market leads us to believe that our estimate of secondary trade volume in SRDA units is accurate.

Issues 2, 3 and 4 below may partially explain the lack of liquidity. Regardless of the cause, lack of secondary liquidity significantly reduces market efficiency. A participant buying an SRDA unit at auction must accept the default scenario that they will never sell that unit.

Given that SRDA units are illiquid, a participant must conservatively estimate the need for SRDA units in their risk management portfolio. Unlike liquid financial contracts such as swaps and caps, SRDA positions cannot easily be reduced when future events change optimal hedging targets.

By allowing NEM participants to sell SRDA units at auction, the guaranteed liquidity events will allow participants to build their SRDA positions to their desired hedge levels, with the knowledge that they could reduce their positions if necessary in response to changing market conditions or portfolio requirements. We understand that there are a number of trader class participants that trade electricity derivatives against SRA positions. They are margined daily on these derivatives but have almost no way to trade the SRA leg of their portfolios, therefore reducing liquidity in the forward market. With units auctioned 3 years in advance and with transmission outage schedules subject to revision at any time there is a need to adjust positions over time.

2. Lack of Anonymity

Currently the only way to sell SRDA units is to enter a bi-lateral financial contract with a counterparty. It is generally recognised that markets function more efficiently when trade can occur anonymously. While Westpac openly quotes SRDA prices both direct to counterparties and through brokers, other participants with physical generation or retail load may not wish to risk revealing their hedge strategy.

Allowing NEM participants to sell SRDA units at auction would provide an anonymous mechanism of sale which does not currently exist elsewhere.

3. Credit and Settlement Risk

Historically, selling SRDA units has involved accepting credit-risk against a financial counter-party. While AEMO and the SRC have recently allowed NEM participants to transfer SRDA units between themselves, this doesn't totally remove counter-party default risk. The risk remains that a counterparty could default in between agreeing a trade and instructing AEMO to transfer SRDA units. Direct trading also requires participants to satisfy multiple regulatory requirements with their counterparty before agreeing the transfer.

Allowing sale of SRDA units at auction would allow sale of SRDAs without incurring credit or settlement risk against counter-parties other than AEMO.

4. Ease of execution

Currently, agreeing to transfer an SRDA unit to another counter-party involves both counter-parties sending AEMO a letter in a specific format with instructions to transfer the SRDA units.

Allowing SRDA units to be sold at auction would substantially simplify the trade confirmation and settlement process, as it would be incorporated into the existing auction processes.

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5. Market preference for trade at auction

The concentration of trade in primary SRDA units at an auction and secondary SRDA units around an auction demonstrates that the market as a whole values the auction process. Issues 1-4 above could partially explain that preference. Another possible cause might be that participants' planning and risk review processes are scheduled on a quarterly basis and timed around the settlement residue auction.

Regardless of the cause, the preference exists to trade SRDA units on or close to settlement residue auction dates. Allowing sale of SRDA units at auction would allow for higher volumes to be traded through the auction process, which the market has demonstrated an appetite for.

6. Market inefficiency

Issues 1-4 above contribute to pricing inefficiency in SRDA units. Incorrectly priced SRDA units reveal less information, distribute risk less efficiently and ultimately result in increased costs to consumers. A common market outcome is for the SRA clear prices to be well above where we would sell the units, but not be able to find a buyer in the market.

7. Auction participant default

Default of auction participants that hold SRDA units has occurred in the past. Such a default creates the risk of losses occurring to TNSPs (and therefore consumers) if the market value of SRDA units decreases in the period between when the defaulting auction participant purchased the units and when the units are finally offered for resale.

By allowing auction participants the ability to get out of SRDA unit trades earlier, participants would be more able to actively decrease their risk when desired, lowering the exposure under a default event.

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a) price, quality, safety, reliability and security of supply of electricity; and

b) the reliability, safety and security of the national electricity system.

Westpac believes that the National Energy Rules already recognize that efficiency in the settlements residue market contributes to the NEO as National Energy Rule 3.18.3(b) states:

In developing and amending the auction rules, AEMO must give effect to the following principles:

(1) [Deleted]

(2) to the extent reasonably practicable, an auction must be structured in a way that maximises the value of the relevant settlements residue;

(3) the price for each unit of the settlements residue in respect of a directional interconnector will be the same for all SRD agreements resulting from the same auction and will be equal to the auction clearing price in respect of the directional interconnector for the auction; and

(4) enhancing competition and efficiency by promoting interstate trade in electricity.

Principle 2 refers to the maximisation of value from the settlements residue. As noted above, institutions participating in SRA auctions must consider the lack of liquidity and consequent inability to sell the units when determining their value and submitting a bid. The illiquidity results in more conservative valuations and a lower clearing price. An efficient, liquid market for any commodity greatly contributes to the willingness of market participants to engage. Accordingly, whilst the addition of volume for sale at a given auction might appear contrary to the objective of maximising value at first glance, it is likely that the increased desirability of SRDA units due to improved liquidity will raise SRDA unit values in general.

The value of extra SRA unit liquidity was confirmed by the SRC in 2000 when the Victorian jurisdiction had a large number of Snowy-Vic SRA units that were not available for auction as they had not been released prior to the first auction of these units. The units were offered on the condition that any

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participant that wanted to return units purchased already could. No units were returned and the extra liquidity was very valuable for the 2000/2001 summer especially as clearing prices escalated significantly.

With regard to principle 4, allowing sellers to participate in the settlements residue auction directly enhances competition and efficiency in interstate trade of electricity.

The rule change also supports the NEO by promoting the overall efficiency of the electricity market. By allowing participants to adjust the volume of SRDA units in their risk portfolio, participants can more closely approach an efficient frontier of risk/reward tradeoff. Also, allowing sellers as well as buyers to determine the price of SRDA units at auction will increase the amount of information captured within the SRDA unit prices. SRDA unit prices can provide market network service providers or regulators with a guide to the value of network enhancement between two regions.

Costs, Benefits and Potential impacts

This rule change would incur costs to purchasers of SRDA units via higher auction fees as AEMO would pass on any increased cost of running the auction.

Costs to AEMO

AEMO have advised that their cost estimate for implementation is \$195-285k. In 2016, the total value of auction proceeds was over \$150 million. If AEMO's costs were recovered over only 1 year of higher auction fees, it would add 0.15% to the cost of SRDA units. To put these costs in context, trading electricity futures contracts on the Sydney Futures Exchange costs participants 0.1-0.2%.

Benefits to sellers

Benefits to sellers include liquidity, anonymity, simplified execution and reduced default, credit and settlement risk, which are all extremely hard to quantify.

Net value is created by trading when an item has a different value to a buyer and a seller. In the case of SRDA units, participants might have different needs for SRDA units based on the inter-regional mismatch between customer liabilities, generation and hedging contracts.

Again, making the comparison again to the Sydney Futures Exchange (and other financial markets), participants already strongly value the liquidity, anonymity, simplified execution and reduced credit risk that a centralized platform and counter-party can provide and their willingness to trade under the SFE's cost structure demonstrate that the value created by an exchange is greater than the costs incurred.

Benefits to buyers

We anticipate that financial intermediaries such as Westpac will act as market makers and offer SRDA units for sale in multiple categories. The increased units available for sale at each auction will allow participants to quickly build an SRDA position to their desired level if required to meet shifts in risk portfolio requirements.

Potential impacts

It is unclear the proposed change in SRDA units would cause any shift in the value of SRDA units large enough to be distinguishable from the usual price movements. We note that because the rule change proposal specifies that no participant could go short SRDA units, that every seller of SRDA units is also a buyer of SRDA units at an earlier point in time. Therefore allowing sale of SRDA units at auction doesn't create an overall change in supply or demand of units and therefore shouldn't affect the price. However, if participants strongly value the increased liquidity that sale at auction creates, then SRDA units might become fundamentally more valuable.

We anticipate that participants will bid more confidently in longer dated SRDA units as they would be able to reduce their position size in response to changing requirements in their risk portfolio. We also anticipate that more financial intermediaries will enter the SRDA market and act as price makers around auctions.

Appendix 2 – Specific rule change

3.18.1 Settlements residue concepts

- (a) An *auction participation agreement* is an agreement between *AEMO* and an *eligible person* concerning the participation by the *eligible person* in *auctions*.
- (b) A *settlements residue distribution agreement* or *SRD agreement* is an agreement between *AEMO* and an *eligible person* entered into following an *auction* under which:
 - (1) *AEMO* agrees to distribute to the *eligible person* a portion of the *settlements residue* allocated to a *directional interconnector* for a period specified in the *SRD agreement*;
 - (2) the *eligible person* agrees to pay *AEMO* a certain amount for the right referred to in clause 3.18.1(b)(1); and
 - (3) the *eligible person* may offer to *AEMO* to cancel all or part of the right referred to in clause 3.18.1(b)(1) in consideration for *AEMO* agreeing to pay the *eligible person* a certain amount for the cancellation.
- (b1) A portion of the *settlements residue* to which an *eligible person* had a right referred to in clause 3.18.1(b)(1) that is cancelled may be made available by *AEMO* in another *auction*.
- (c) For the purposes of this rule 3.18:
 - (1) all the *regulated interconnectors* between any 2 adjacent *regions* are deemed to constitute a single *interconnector*; and
 - (2) the deemed *interconnector* referred to in clause 3.18.1(c)(1) between any 2 adjacent *regions* consists of 2 *directional interconnectors*, one involving a transfer from *region A* to *region B*, and one involving a transfer from *region B* to *region A*.
- (d) Subject to clause 3.18.4, *AEMO* must use the portion of the *settlements residue* allocated to a *directional interconnector* remaining after applying the relevant *jurisdictional derogations* under Chapter 9 (as determined by applying the principles referred to in clause 3.6.5) to make payments under *SRD agreements* (except payments to *eligible persons* for cancellation of the right referred to in clause 3.18.1(b)(1)) in relation to that *directional interconnector* and to recover the *auction expense fees*.
- (e) Where a person registered as a *Trader* is required to appoint an agent for the purposes of rule 2.5A(c)(2), *AEMO* and the *Trader* must ensure that the *auction participation agreement* and the *SRD agreement* entered into by the *Trader* and its agent provides that the *Trader* and the agent are jointly and severally liable in relation to the obligations of the *Trader* under those agreements.

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3.18.4 Proceeds and fees

- (a) *AEMO* must distribute:
- (1) subject to clauses 3.6.5(a)(4), 3.6.5(a)(4A) and 3.18.4(a1), proceeds from each *auction* in respect of a *directional interconnector*; and
 - (2) subject to clauses 3.18.4(d) and (e), any portion of the *settlements residue* allocated to the *directional interconnector* which is not the subject of a *SRD agreement*,
- to the appropriate *Network Service Providers* in accordance with the principles referred to in clause 3.6.5 in relation to the allocation and distribution of *settlements residue* attributable to *regulated interconnectors*.
- (a1) The amounts paid by *AEMO* to an *eligible person* for cancellation of the right referred to in clause 3.18.1(b)(1) will be recovered from the proceeds of the *auction* in which the portion of *settlement residue* to which that right related is made available.
- (a2) If the full amount paid by *AEMO* to *eligible person* for cancellation of the right referred to in clause 3.18.1(b)(1) cannot be recovered from the proceeds of any *auction* in which the portion of *settlement residue* to which that right related is made available, then *AEMO* must recover the amount that could not be recovered from the appropriate *Network Service Provider* in accordance with clause 3.6.5 as if references to negative *settlement residue* amount were references to the difference between the amounts paid by *AEMO* to *eligible person* for cancellation of the right referred to in clause 3.18.1(b)(1) and the proceeds of *auctions*.
- (b) The costs and expenses incurred by *AEMO* in establishing and administering the arrangements contemplated by this rule 3.18, in conducting *auctions* under this rule 3.18 and in entering into and administering *auction participation agreements* and *SRD agreements* under this rule 3.18 will be recovered from *settlements residue* by way of *auction expense fees*.
- (c) The *auction expense fees* are to be developed by *AEMO* in accordance with the *auction rules* and approved by the *settlement residue committee*, and recovered as follows:
- (1) to the extent the *settlements residue* is distributed to *eligible persons* under clause 3.18.1(d), in accordance with the *auction rules*; and
 - (2) to the extent the *settlements residue* is distributed to *Network Service Providers* under clause 3.18.4(a)(2), as if the *settlements residue* was being distributed to *eligible persons* in accordance with the *auction rules*.
- (d) The *auction expense fees* for an *auction* are to be *published* before the *auction*.
- (e) *Eligible persons* and *AEMO* must pay *auction amounts* in accordance with the *auction rules*, and, for the avoidance of doubt, amounts payable by *eligible persons* to *AEMO* under *SRD agreements* and amounts payable by

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AEMO to eligible persons for cancellation of the right referred to in clause 3.18.1(b)(1) will not be regarded as amounts payable under the *Rules* for the purposes of rule 3.15.

Note

This clause is classified as a civil penalty provision under the National Electricity (South Australia) Regulations. (See clause 6(1) and Schedule 1 of the National Electricity (South Australia) Regulations.)

- (f) *AEMO* may nominate an electronic funds transfer facility for the purposes of paying *auction amounts* and, if it does so, *eligible persons*, *Network Service Providers* and *AEMO* must use that facility for paying and receiving *auction amounts*.

Appendix 3 – Explanation of Changes

Clause	Proposed Change	Explanation
New subparagraph 3.18.1(b)(3)	(3) the eligible person may offer to <i>AEMO</i> to cancel all or part of the right referred to in clause 3.18.1(b)(1) in consideration for <i>AEMO</i> agreeing to pay the <i>eligible person</i> a certain amount for the cancellation.	<p>This recognises that the auction may involve participants offering units back to <i>AEMO</i>, although it does not mandate any change as <i>AEMO</i> is not obliged to agree.</p> <p>The approach of the units being cancelled and re-issued (rather than transferred) is intended to be consistent with the existing ASIC relief from financial services regulation of the <i>SRA</i>.</p> <p>The structure and terminology of the new subparagraph is consistent with (b)(2) and is intended to retain the obligation to pay the original amount determined in (b)(2) despite the cancellation.</p> <p>It is expected that the price of the cancellations (i.e. the “certain amount” in (b)(3)), would align with the clearing price of the contemporary auction (i.e. the “certain amount” in (b)(2)), however these specifics are managed by the Auction Rules and the <i>SRDA</i>.</p>
New paragraph 3.18.1(b1)	(b1) A portion of the settlements residue to which an eligible person had a right referred to in clause 3.18.1(b)(1) that is cancelled may be made available by <i>AEMO</i> in another auction.	<p>This is included to expressly allow for secondary sales through the existing auction mechanism.</p> <p>The right of the original unitholder to settlement residue will be cancelled, and independently of that transaction, <i>AEMO</i> may make the settlement residue available in another auction and enter into a new <i>SRDA</i> with a new holder of equivalent units.</p>
Change to 3.18.1 (d)	Include after “ <i>SRD agreements</i> ” the text “...(except payments to <i>eligible persons</i> for cancellation of the right referred to in clause 3.18.1(b)(1))...”	Consequential change. Ensures that settlement residue is not used for payments by <i>AEMO</i> for cancellation of units.

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Note on 3.18.3(a)(2-6)	No change needed.	3.18.3(a) gives considerable powers to AEMO to develop specific operational details of the settlement residue auction - including those relating to the secondary trading of SRDA units.
3.18.4(a)(1)	Insert “and 3.18.4(a1),” ahead of “proceeds”	Consequential change. The amounts paid by AEMO for cancellation of units will be deducted from the proceeds of an auction before the proceeds are distributed to NSPs.
New paragraph 3.18.4(a1)	The amounts paid by <i>AEMO</i> to an <i>eligible person</i> for cancellation of the right referred to in clause 3.18.1(b)(1) will be recovered from the proceeds of the <i>auction</i> in which the portion of <i>settlement residue</i> to which that right related is made available .	This gives AEMO the right to recover the amounts paid for cancellation of units from the proceeds of auctions.
New paragraph 3.18.4(a2)	If the full amount paid by <i>AEMO</i> to <i>eligible person</i> for cancellation of the right referred to in clause 3.18.1(b)(1) cannot be recovered from the proceeds of any auction in which the portion of <i>settlement residue</i> to which that right related is made available, then <i>AEMO</i> must recover the amount that could not be recovered from the appropriate <i>Network Service Provider</i> in accordance with clause 3.6.5 as if references to negative <i>settlement residue</i> amount were references to the difference between the amounts paid by <i>AEMO</i> to <i>eligible person</i> for cancellation of the right referred to in clause 3.18.1(b)(1) and the proceeds of <i>auctions</i> .	In the existing arrangements, when an auction participant is suspended, its held units are re-auctioned, potentially lowering the proceeds ultimately paid to the relevant Network Service Provider (NSP). The SRC desired that the existing credit arrangements should not change as a result of the secondary trading. The SRC has analysed situations where an auction participant who had engaged in secondary trading is subsequently suspended. The SRC identified that if their sale price was below their original purchase price, there would be a consequential reduction in the total proceeds available to the relevant NSP. In the extreme case, the total proceeds of a relevant directional interconnector for one vintage could be negative. In the unlikely event that the amounts paid for cancellation of units cannot be recovered from the proceeds of auctions, this new paragraph enables AEMO to recover the balance from the NSPs. The same mechanism for recovery of negative settlement residue in NER 3.6.5 is used for consistency.

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- 3.18.4(e) Insert after “*SRD Agreements*” “...and amounts payable by *AEMO* to *eligible persons* for cancellation of the right referred to in clause 3.18.1(b)(1)...”
- Consequential change. Auction amounts includes amounts payable to AEMO or eligible persons under SRD agreements;
- Therefore, amounts payable by AEMO to eligible persons for cancellation of the right referred to in clause 3.18.1(b)(1) under SRD agreements would be ‘auction amounts’.
- Therefore, consistent with amounts payable by eligible persons to AEMO under SRDA’s (for unit purchases), amounts payable by AEMO to eligible persons under SRDA’s (for secondary unit sales) are not regarded as auction amounts payable under the Rules. The settlement of secondary SRDA unit sales would be outlined in the Settlement Residue Auction Rules as per the settlement of SRDA unit purchases.