



In reply please quote D17021604

Mr Istvan Szabo
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney, NSW, 2000

Dear Mr Szabo

Draft Rule Determination: Secondary Trading of Settlement Residue Distribution Units

The Energy and Technical Regulation Division (Division) of the Department of Premier and Cabinet thank you for the opportunity to comment on the Australian Energy Market Commission's (AEMC) Draft Determination regrading *Secondary Trading of Settlement Residue Distribution Units*.

The Division notes the AEMC's National Electricity Rules (NER) preferable draft rule which allows secondary trading of settlement residue distribution units to be facilitated through the settlement residue auctions process.

The Division supports the AEMC's conclusion that increased liquidity is likely to improve the effectiveness of units as inter-regional hedging instruments. The Division has advocated that with a greater supply of units being offered for auction (ie the secondary market pooled with the primary), this would reduce the price of risk so that wholesale purchase of electricity costs by retailers would be lower, benefitting all consumers in the long run and meeting the national electricity objective.

However, the AEMC's preferable draft rule amends the original rule change proposal. The approach by the AEMC is to introduce the concept of primary and secondary units in order to allocate the risk of default from a secondary seller or buyer to secondary sellers. It is important to note that the intent of minor rule change request from Westpac was to not alter the way in which default risk is managed, that is that the default risk would continue to be borne by transmission network service providers (TNSPs).

The Division is concerned therefore that the approach undertaken by the AEMC in regards to counterparty default in the secondary market creates barriers to the efficient introduction of secondary trading market. The Australian Energy Market Operator (AEMO) have indicated to a recent settlement residue committee (SRC) meeting on 17 August 2017 that implementing the draft rule would introduce greater complexity in the design of the auction rules for secondary trading and introduce greater implementation costs as result of the likelihood of requiring a financial services licence exemption relief from Australian Securities and Investments Commission.

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As the AEMC have indicated, if the SRC consider implementation of secondary trading, the auction rules cannot be amended in way that is inconsistent with the NER draft rule.

The Division therefore is asking the AEMC to reconsider its approach in the draft rule in regards to default risk and revert to the original rule change proposal which continued with the current risk mitigation arrangements.

At the SRC meeting AEMO proposed an option whereby the draft rule should continue to have the default risk be borne by TNSPs for secondary trading (as proposed in the rule change proposal) with some high level principles to be introduced in the NER so as to prevent increased counterparty risk for TNSPs. Under this arrangement the Division is of the view that the AEMC's concerns on allocating default risk in the draft rule can be substantially ameliorated.

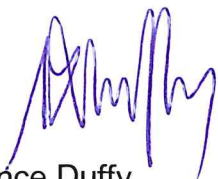
Where a buyer of secondary units is not able to meet its financial obligations (ie defaults) those principles in the NER would therefore act as necessary safeguards. Those principles for example could be based on the aims of limiting the number of secondary units that can be offered for sale in an auction or requiring the cash settling of secondary trading losses (after the transaction had been completed). These are somewhat similar to the options presented in the AEMC's Consultation Paper in regards to specific measures to prevent increased counterparty risk for TNSPs. The SRC, when considering development of secondary trading, would then have responsibility in its implementation as guided by the NER high level principles.

The Division however is of the view that defaults in relation to secondary market trading would be rare and very unlikely, and any perceived increase in default risk would be orders of magnitude smaller than the default risk already present in the settlement residue distribution units market. We understand that to date, in the primary Settlements Residue market, there has only one instance in which a participant has defaulted, when the purchaser was in administration and actions under the prudential arrangements administered by AEMO were effectively undertaken.

It is also conceivable though that without changes to the AEMC draft rule as highlighted above, the ability to implement secondary trading could remain dormant in the NER and never be utilised which would be a highly undesirable sub-optimal outcome from the rule change process.

If you have any questions regarding this submission or are seeking further clarification please contact me on (08) 8204 1724.

Yours sincerely



Vince Duffy
Executive Director Energy and Technical Regulation

15 September 2017