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EnergyAustralia[®]

30 March 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
Level 16
1 Margaret Street
SYDNEY NSW 2001

Dear John,

**Request for Participant Derogation to the National Electricity Rules re
EnergyAustralia's participation in Settlement Residue Auctions**

Please find attached a request by EnergyAustralia ABN 67 505 337 385, for a Participant Derogation to be made as a "non-controversial Rule" (as defined in section 87 of the National Electricity Law).

This request is further to a Participant Derogation previously granted by the Commission on 16 June 2006 and which is due to expire on 30 June 2009. If granted, it will provide EnergyAustralia with the unambiguous right to participate in settlement residue auctions conducted by NEMMCO under the National Electricity Rules.

Should you require any further information or require clarification on any aspect of this request please contact Nicholas Convery, Executive Manager Retail Regulation on (02) 9269 2485.

Yours sincerely

Mike Bailey
Executive General Manager Retail

Request for Participant Derogation to the National Electricity Rules

EnergyAustralia
ABN 67 505 337 385

Date: 30 March 2009

REQUEST FOR PARTICIPANT DEROGATION TO THE NATIONAL ELECTRICITY RULES

1. NAME AND ADDRESS OF PERSONS MAKING THE REQUEST

[Refer Regulation 8(1)(a)]

This request is made under section 91(5) of the National Electricity Law by EnergyAustralia ABN 67 505 337 385.

EnergyAustralia is a statutory State owned corporation constituted under the Energy Services Corporations Act 1995 (NSW) and is also a Registered Participant in the National Electricity Market (**NEM**).

EnergyAustralia's address is:

570 George Street
SYDNEY NSW 2000

2. DESCRIPTION OF PROPOSED PARTICIPANT DEROGATION

[Refer Regulation 8(1)(b)]

On 16 June 2006 the Australian Energy Market Commission (the **Commission**) approved a participant derogation in favour of EnergyAustralia (**Attachment 1**). This followed a joint request by both NEMMCO and EnergyAustralia to provide EnergyAustralia with the unambiguous right to participate in settlement residue auctions conducted by NEMMCO under the National Electricity Rules.

In approving the request, the *Commission* provided that the derogation would expire on the earliest of five separate conditions occurring, one of which was 30 June 2009. With this expiration date approaching, EnergyAustralia has considered its position in relation to the existing participant derogation and now wishes to have the benefit provided by it extend beyond this date.

As such, it is proposed that a participant derogation, either by way of an extension to the existing derogation or by the approval of a new one which is identical in content, be made as a "non-controversial Rule" in relation to EnergyAustralia and inserted into Chapter 8A of the National Electricity Rules.

The Participant Derogation will provide as follows:

- (a) The reference in clause 3.18.2(g)(2) to *Transmission Network Service Provider* does not include EnergyAustralia.
- (b) If this *participant derogation* expires due to the occurrence of the event in clause 8A.2.2(4) of clause 8A2.2, then and *SRD agreement* between

NEMMCO and EnergyAustralia which is in existence on that date, will terminate on that date.

Note: *The clause references in (a) and (b) above are based on those as appear in the existing participant derogation and may be subject to modification in the final rule as it is made.*

The **Effective Date** is the date on which the Participant Derogation comes into effect.

The **Participant Derogation Expiry Date** is the earlier of the following dates:

- (a) 30 June 2012;
- (b) the date that EnergyAustralia's retail business is transferred to a new legal entity pursuant to a NSW Government restructure of EnergyAustralia or by any other means;
- (c) the date that EnergyAustralia ceases to engage in the activity of owning, controlling or operating a *transmission system*; and
- (d) the first date after the Effective Date on which EnergyAustralia engages in the activity of owning, controlling or operating a *transmission system* that NEMMCO determines, in accordance with the criteria developed pursuant to clause 5.6.3(i) of the National Electricity Rules, is capable of having a material impact on *interconnector* capability; or
- (e) the date that EnergyAustralia is not excluded from entering into *SRD Agreements* under clause 3.18.2(g)(2).

3. STATEMENT OF ISSUE

[Refer Regulation 8(1)(c)]

3.1 Summary of issue

The relevant issues can be summarised as follows:

- (a) EnergyAustralia is a Registered Participant under the National Electricity Rules in the categories of:
 - (i) Non-Scheduled Market Generator;

- (ii) Market Customer;
 - (iii) Network Service Provider (Transmission and Distribution); and
 - (iv) Special Participant (Distribution System Operator).
- (b) However, EnergyAustralia submits that its transmission assets are an incidental part of its business, which essentially consists of a ring-fenced retail business and a ring-fenced distribution network business.
- (c) As a result of the reclassification in 2000 of certain distribution assets that run in parallel to TransGrid's transmission network, some of EnergyAustralia's assets now come within the definition of a transmission system in the National Electricity Rules. EnergyAustralia is therefore a Transmission Network Service Provider under the National Electricity Rules.
- (d) Clause 3.18.2(g)(2) of the National Electricity Rules now compels NEMMCO to exclude Transmission Network Service Providers from entering into *SRD Agreements*.
- (e) The current National Electricity Market Settlement Residue Auction Rules (**Auction Rules**), which comply with the National Electricity Rules, effectively provide that:
- (i) NEMMCO will not enter into an Auction Participation Agreement with a Transmission Network Service Provider (as defined in the National Electricity Rules);
 - (ii) a Transmission Network Service Provider cannot participate in settlement residue auctions; and
 - (iii) NEMMCO must reject any Bid by a Transmission Network Service Provider.
- (f) The Auction Participation Agreement between NEMMCO and EnergyAustralia entitles NEMMCO to terminate the Auction Participation Agreement and any or all of the *SRD Agreements* between NEMMCO and EnergyAustralia by written notice to EnergyAustralia if EnergyAustralia ceases to satisfy the requirement of not being registered as a Transmission Network Service Provider.
- (g) It is clear from the Australian Competition and Consumer Commission's (ACCC's) Final Determination authorising the introduction of clause 3.18.2(g) to the National Electricity Code that the rationale for excluding Transmission Network Service Providers from settlement residue auctions was to exclude the entities which owned assets which could be used to manipulate the value of the settlements residue.¹ 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.

¹ ACCC, *Final Determination: Applications for Authorisation, National Electricity Code, Settlements Residue Auction Process*, 22 December 1999, A90688, A90689 and A90690.

- (h) In addition, it is submitted that:
- (i) The competitive neutrality that the National Electricity 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 settlement residue auctions; and
 - (ii) excluding EnergyAustralia does nothing to promote the objectives of the provisions in the National Electricity Rules and disadvantages both EnergyAustralia and its customers.
- (i) The new/extended participant derogation will have the effect of enabling NEMMCO, as is currently the case under the existing derogation, to permit EnergyAustralia to participate in settlement residue auctions. This will continue until such time as this issue is resolved on a long-term basis, either through a change to the National Electricity Rules or a restructure of EnergyAustralia.
- (j) EnergyAustralia asks that this current request for a participant derogation be treated as a request for a “**non-controversial Rule**”. A “non-controversial Rule” is defined in section 87 of the National Electricity Law to mean a Rule that is unlikely to have a significant effect on the NEM. In support of this request, EnergyAustralia makes the following submissions:
- (i) EnergyAustralia’s participation in settlement residue auctions is consistent with the policy outlined in the ACCC’s Final Determination authorising the introduction of clause 3.18.2(g) to the National Electricity Code.
 - (ii) Consistent with the above policy, EnergyAustralia has participated in settlement residue auctions from March 2001 to present – with the exception of a small period in early 2006 when the problem with the wording in the National Electricity Rules and the *Auction Rules* was identified. Following the identification of the problem:
 - (A) The Australian Energy Regulator (AER) wrote to both NEMMCO and EnergyAustralia on 22 March 2006 expressing the view that the current “ambiguity and uncertainty” under the National Electricity Rules and the *Auction Rules* with respect to EnergyAustralia’s right to participate in settlement residue auctions must be rectified “as soon as possible”.
 - (B) Following that notification, EnergyAustralia 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 National Electricity Rules and the *Auction Rules* to unambiguously permit EnergyAustralia to participate in such auctions.

- (C) On further consideration of the matter, including that EnergyAustralia's participation in settlement residue auctions to that time had not had any adverse impact on the operation of settlement residue auctions, EnergyAustralia and NEMMCO made a joint request for a participant derogation to the *Commission* on 13 April 2006.
 - (D) On 16 June 2006 the *Commission* approved a participation derogation in favour of EnergyAustralia.
 - (E) EnergyAustralia has continued its participation in settlement residue auctions since this time.
- (k) The previous circumstances relating to EnergyAustralia's inability to participate in settlement residue auctions remain unchanged as there have been no amendments made to either the National Electricity Rules or the *Auction Rules* that would otherwise facilitate participation without a derogation.
 - (l) EnergyAustralia's participation in settlement residue auctions to date has not had any adverse impact on the operation of settlement residue auctions.
 - (m) Therefore, any continued participation would not have any adverse impact on the operation of settlement residue auctions.
 - (n) With the current derogation due to expire on 30 June 2009 (assuming none of the other conditions warranting its expiry occur earlier), EnergyAustralia requests that the *Commission* extend the existing participant derogation or approve a new one, identical in content, in its favour and that it be inserted into Chapter 8A of the National Electricity Rules.
 - (o) The making of the participant derogation (which will result in EnergyAustralia's ongoing participation in settlement residue auctions) will also not have any adverse impact on the operation of settlement residue auctions.

3.2 Nature and Scope of issue

As noted above, the circumstances within which NEMMCO and EnergyAustralia made their initial request for a participant derogation in 2006 remain unchanged. So much so, **Attachment 2** is a copy of that request and is provided here to outline the substantive detail on the issue for which this current request is made.

The *Commission* is, for the purposes of this section 3 of the current request, directed to sections 3.2 & 3.3 (pp 5-10, inclusive) of *Attachment 2* for detailed commentary on the nature and scope of the issue.

3.3 **How issue will be addressed by the proposal**

As discussed in section 2 above, it is proposed to include the participant derogation in Chapter 8A of the National Electricity Rules.

If the participant derogation is made / extended by the *Commission*, NEMMCO will be able to continue its current action of not having to specify criteria in its *Auction Rules* which would, without any such derogation, exclude EnergyAustralia from participating in settlement residue auctions.

As the existing derogation is still in place there will be no need for NEMMCO to make any modifications to their *Auction Rules*.

In light of this participant derogation being approved, EnergyAustralia will consider whether any amendments are necessary to its Auction Participation Agreement and will communicate these directly to NEMMCO with a view to making these amendments via written agreement between the parties.

4. **HOW THE PROPOSAL WILL CONTRIBUTE TO THE NEM OBJECTIVE**

[Refer Regulation 8(1)(d)]

4.1 **The Objective of the National Electricity Market**

Clause 7 of the National Electricity Law provides that the *NEM* objective is:

“to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system”

4.2 **Contribution to the objective of the National Electricity Market**

EnergyAustralia submits that the approval of a new / extended participant derogation will promote the *NEM* objective because by allowing the largest retailer in NSW to participate in settlement residue auctions in circumstances where other retailers have access to settlement residue auctions:

(a) from the perspective of the end-use customer:

- (i) it will continue to provide the largest retailer in NSW with access to the full range of potential hedging transactions to reduce the significant financial risks borne by retailers trading in the *NEM*;
- (ii) this access enables EnergyAustralia to have electricity costs that reflect the entire range of transactions available in the market; and

- (iii) EnergyAustralia is able to reflect these costs in the prices that it charges to end-use customers who will then be able to make economically rational consumption decisions based on the costs they face; and
- (b) from the perspective of the Network Service Providers who ultimately receive the proceeds from each auction:
 - (i) by allowing the largest retailer in NSW to continue to participate in settlement residue auctions, it will enable the prices bid for settlement residue units to reflect their real value to the market, thus ensuring that the proceeds Network Service Providers receive from each settlement residue auction reflect the true value to the market.

EnergyAustralia also considers that competitive neutrality and the interests of its customers require that EnergyAustralia has the same access to settlement residue auctions as other retailers against whom it competes.

Indeed the *Commission*, in its 2006 Rule Determination² was 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 hedge instruments. This leads to benefits for end users in the NEM through more efficient energy market prices”.

and further:

“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.

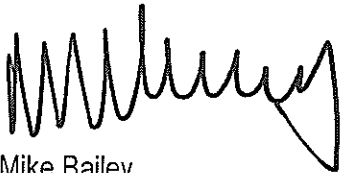
The Commission is therefore satisfied that it is in the long term interest of electricity consumers, and that it will contribute to the achievement of the national electricity market objective, for this participant derogation to be approved, allowing EnergyAustralia to participate in the SRA process.”

² AEMC Rule Determination, *National Electricity Amendment (Energy Participant Derogation (Settlement Residue Auctions)) Rule 2006*. 16 June 2006.

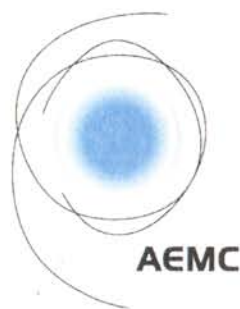
5. POWER OF AEMC TO MAKE PARTICIPANT DEROGATION

The *Commission's* power to make the requested participant derogation and the relevant procedures to be followed are contained in Part 4 and Part 7 of the National Electricity Law respectively.

The nature of this request falls within the subject matters on which the *Commission* may make Rules as set out generally in section 34 and Schedule 1 of the NEL. Specifically, section 34(3)(l) permits the *Commission* to, by way of a participant derogation, exempt a Registered Participant from complying with a provision, or a part of a provision, of the Rules.

A handwritten signature in black ink, appearing to read 'Mike Bailey', with a stylized, cursive script.

Mike Bailey
Executive General Manager Retail



National Electricity Amendment (EnergyAustralia Participant Derogation (Settlement Residue Auctions)) Rule 2006 No.9

under the National Electricity Law as applied by:

- (a) the National Electricity (South Australia) Act 1996; and
- (b) the Electricity (National Scheme) Act 1997 of the Australian Capital Territory; and
- (c) the National Electricity (New South Wales) Act 1997 of New South Wales; and
- (d) the Electricity - National Scheme (Queensland) Act 1997 of Queensland; and
- (e) the Electricity - National Scheme (Tasmania) Act 1999 of Tasmania; and
- (f) the National Electricity (Victoria) Act 1997 of Victoria; and
- (g) the Australian Energy Market Act 2004 of the Commonwealth.

The Australian Energy Market Commission makes the following Rule under the National Electricity Law.



John Tamblyn
Chairman
Australian Energy Market Commission

National Electricity Amendment (EnergyAustralia Participant Derogation (Settlement Residue Auctions)) Rule 2006 No.9

1. Title of Rule

This Rule is the *National Electricity Amendment (EnergyAustralia Participant Derogation (Settlement Residue Auctions)) Rule 2006 No.9*.

2. Commencement

This Rule commences operation on 22 June 2006.

3. Amendment of the National Electricity Rules

The National Electricity Rules are amended as set out in Schedule 1.

Schedule 1 Amendment of National Electricity Rules

(Clause 3)

[1] Chapter 8A Participant derogations

Omit the heading:

**Part 2 – Derogations Granted to New South Wales
Generators**

Insert:

Part 2 – Derogations Granted to EnergyAustralia

**8A.2 Derogation from clause 3.18.2(g)(2) - Auctions and
eligible persons**

8A.2.1 Definitions

In this *participant derogation*, rule 8A.2:

commencement date means the day the National Electricity Amendment (EnergyAustralia Participant Derogation (Settlement Residue Auctions)) Rule 2006 commences operation.

EnergyAustralia means the energy distributor known as EnergyAustralia and established under the Energy Services Corporations Act 1995 (NSW).

8A.2.2 Expiry date

This *participant derogation* expires on the earlier of:

- (1) 30 June 2009;
- (2) the date that EnergyAustralia's retail business is transferred to a new legal entity pursuant to a NSW Government restructure of EnergyAustralia or by any other means;
- (3) the date that EnergyAustralia ceases to engage in the activity of owning, controlling or operating a *transmission system*;
- (4) the first date after the commencement date on which EnergyAustralia engages in the activity of owning, controlling or operating a *transmission system* that NEMMCO determines, in accordance with the criteria developed pursuant to clause 5.6.3(i), is capable of having a material impact on *interconnector* capability; or

-
- (5) the date that EnergyAustralia is not excluded from entering into *SRD agreements* under clause 3.18.2(g)(2).

8A.2.3 Derogation

- (a) The reference in clause 3.18.2(g)(2) to *Transmission Network Service Provider* does not include EnergyAustralia.
- (b) If this *participant derogation* expires due to the occurrence of the event in clause 8A.2.2(4) of clause 8A2.2, then any *SRD agreement* between *NEMMCO* and EnergyAustralia which is in existence on that date, will terminate on that date.

RECEIVED

18 APR 2006

Also on behalf of
Energy Australia

13 April 2006

Dr John Tamblyn
Chairman
Australian Energy Market Commission
Level 16
1 Margaret Street
SYDNEY NSW 2001

Dear John

**Request for Participant Derogation to the National Electricity Rules
re EnergyAustralia's participation in Settlement Residue Auctions**

Further to our recent discussions with the Commission's Mr Murray Chapman and Ms Rhonda Andriueax, we enclose a request by the National Electricity Market Management Company Limited ABN 94 072 010 327 (NEMMCO) under section 91(6) of the National Electricity Law, on behalf of NEMMCO and EnergyAustralia ABN 67 505 337 385, for a Participant Derogation to be made as a "non-controversial Rule" (as defined in section 87 of the National Electricity Law).

The Participant Derogation is intended to provide EnergyAustralia with an unambiguous right to participate in settlement residue auctions conducted by NEMMCO under the National Electricity Rules.

Please contact either Brian Spalding (on 02 9239 9103) or Tim O'Grady (on 02 9269 4911) if you require any further information.

Yours sincerely



Brian Spalding
Chief Operating Officer
NEMMCO



Tim O'Grady
General Manager Retail
EnergyAustralia

Request for Participant Derogation to the National Electricity Rules

National Electricity Market Management Company Limited
ABN 94 072 010 327

EnergyAustralia
ABN 67 505 337 385

Date: 13 April 2006

Request for Participant Derogation to the National Electricity Rules

1. Name and address of persons making the request

[Refer Regulation 8(1)(a).]

This request is made under section 91(6) of the National Electricity Law by National Electricity Market Management Company Limited ABN 94 072 010 327 (**NEMMCO**) on behalf of itself and EnergyAustralia ABN 67 505 337 385.

NEMMCO is, among other things, responsible under the National Electricity Rules for:

- (a) operating and administering the spot market for the wholesale sale and purchase of electricity;
- (b) developing auction rules to apply to settlement residue auctions; and
- (c) conducting settlement residue auctions in accordance with those auction rules and distributing the settlements residues in accordance with the results of those auctions.

NEMMCO's Sydney address is:

Level 22 Norwich House
6-10 O'Connell Street
Sydney NSW 2000

EnergyAustralia is a statutory State owned corporation constituted under the Energy Services Corporations Act 1995 (NSW) and is also a Registered Participant in the National Electricity Market (**NEM**).

EnergyAustralia's address is:

570 George Street
Sydney NSW 2000

2. Description of proposed Participant Derogation

[Refer Regulation 8(1)(b).]

It is proposed that a participant derogation, as set out in this section (**Participant Derogation**), be made as a "non-controversial Rule" in relation to NEMMCO and EnergyAustralia and inserted into Chapter 8A of the National Electricity Rules.

The Participant Derogation will provide as follows:

For the purpose of clause 3.18.2(g)(2), the reference in that clause to *Transmission Network Service Providers* is deemed to exclude EnergyAustralia (ABN 67 505 337 385).

The Participant Derogation will apply from the Effective Date to the Participant Derogation Expiry Date (inclusive) (**Derogation Period**).

The Participant Derogation will provide that, subject to one qualification, any *SRD agreements* validly entered into between *NEMMCO* and EnergyAustralia during the Derogation Period in accordance with the National Electricity Rules (as amended by the 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 those *SRD agreements*. The qualification is that if the Participant Derogation ceases to apply due to the occurrence of the event in paragraph (d) of the definition of Participant Expiry Date then any *SRD agreements* will also terminate on the date on which that event occurs.

The **Effective Date** is the date on which the Participant Derogation comes into effect.

The **Participant Derogation Expiry Date** is the earlier of the following dates:

- (a) 30 June 2009;
- (b) the date that EnergyAustralia's retail business is transferred to a new legal entity pursuant to a NSW Government restructure of EnergyAustralia or by any other means;
- (c) the date that EnergyAustralia ceases to engage in the activity of owning, controlling or operating a *transmission system*; and
- (d) the first date after the Effective Date on which EnergyAustralia engages in the activity of owning, controlling or operating a *transmission system* that NEMMCO determines, in accordance with the criteria developed pursuant to clause 5.6.3(i) of the National Electricity Rules, is capable of having a material impact on *interconnector* capability.

3. Issue concerning existing Rule and how proposed Rule will address this issue

[Refer Regulation 8(1)(c).]

3.1 Summary of issues

The relevant issues can be summarised as follows:

- (a) EnergyAustralia is a Registered Participant under the National Electricity Rules in the categories of:
 - (i) Non-Scheduled Market Generator;
 - (ii) Market Customer;
 - (iii) Network Service Provider (Transmission and Distribution); and
 - (iv) Special Participant (Distribution System Operator).
- (b) However, EnergyAustralia submits that its transmission assets are an incidental part of its business, which essentially consists of a ring-fenced retail business and a ring-fenced distribution network business.
- (c) As a result of the reclassification in 2000 of certain distribution assets that run in parallel to TransGrid's transmission network, some of EnergyAustralia's assets now come within the definition of a transmission system in the National Electricity Rules. EnergyAustralia is therefore a Transmission Network Service Provider under the National Electricity Rules.

- (d) Clause 3.18.2(g)(2) of the National Electricity Rules now compels NEMMCO to exclude Transmission Network Service Providers from entering into settlement residue distribution agreements (**SRD Agreements**).
- (e) The current National Electricity Market Settlement Residue Auction Rules (**Auction Rules**), which comply with the National Electricity Rules, effectively provide that:
- (i) NEMMCO will not enter into an Auction Participation Agreement with a Transmission Network Service Provider (as defined in the National Electricity Rules);
 - (ii) a Transmission Network Service Provider cannot participate in settlement residue auctions; and
 - (iii) NEMMCO must reject any Bid by a Transmission Network Service Provider.
- (f) The Auction Participation Agreement between NEMMCO and EnergyAustralia entitles NEMMCO to terminate the Auction Participation Agreement and any or all of the SRD Agreements between NEMMCO and EnergyAustralia by written notice to EnergyAustralia if EnergyAustralia ceases to satisfy the requirement of not being registered as a Transmission Network Service Provider.
- (g) It is clear from the Australian Competition and Consumer Commission's ("**ACCC's**") Final Determination authorising the introduction of clause 3.18.2(g) to the National Electricity Code that the rationale for excluding Transmission Network Service Providers from settlement residue auctions was to exclude the entities which owned assets which could be used to manipulate the value of the settlements residue.¹ 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.
- (h) In addition, EnergyAustralia submits that:
- (i) the competitive neutrality that the National Electricity 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 settlement residue auctions; and
 - (ii) excluding EnergyAustralia does nothing to promote the objectives of the provisions in the National Electricity Rules and disadvantages both EnergyAustralia and its customers.
- (i) This Participant Derogation is intended to enable NEMMCO to permit EnergyAustralia to participate in settlement residue auctions until this issue is resolved on a long-term basis, either through a change to the National Electricity Rules or a restructure of EnergyAustralia.
- (j) NEMMCO and EnergyAustralia ask that this request for a Participation Derogation be treated as a request for a "**non-controversial Rule**". A "non-controversial Rule" is defined in section 87 of the National Electricity Law to mean a Rule that is unlikely to have a significant effect on the NEM. In support of this request, EnergyAustralia makes the following submissions:

¹ ACCC, *Final Determination: Applications for Authorisation, National Electricity Code, Settlements Residue Auction Process*, 22 December 1999, A90688, A90689 and A90690.

- (i) EnergyAustralia's participation in settlement residue auctions is consistent with the policy outlined in the ACCC's Final Determination authorising the introduction of clause 3.18.2(g) to the National Electricity Code.²
- (ii) Consistent with the above policy, EnergyAustralia has participated in settlement residue auctions from March 2001 until recently (when the problem with the wording in the National Electricity Rules and the Auction Rules was identified). Following the identification of the problem:
 - (A) The Australian Energy Regulator (**AER**) has written to both NEMMCO and EnergyAustralia expressing the view that the current "ambiguity and uncertainty" under the National Electricity Rules and the Auction Rules with respect to EnergyAustralia's right to participate in settlement residue auctions 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 National Electricity Rules and the Auction Rules to unambiguously permit EnergyAustralia to participate in such auctions.
- (iii) EnergyAustralia's participation in settlement residue auctions to date has not had any adverse impact on the operation of settlement residue auctions.
- (iv) Therefore, any resumption by EnergyAustralia of such participation would not have any adverse impact on the operation of settlement residue auctions (and would be consistent with the ACCC's policy).
- (v) Therefore, the making of the Participant Derogation (which will result in EnergyAustralia resuming participation in settlement residue auctions) will also not have any adverse impact on the operation of settlement residue auctions.
- (k) As discussed below, NEMMCO proposes to amend the Auction Rules in accordance with the procedure in the National Electricity Rules to be consistent with the changes to the National Electricity Rules made by this Participation Derogation. NEMMCO and EnergyAustralia 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.

3.2 Detailed discussion of issue under the existing Rule

(a) Effect of previous version of clause 3.18.2(g)(2) under the National Electricity Code

Prior to the National Electricity Code being replaced by the National Electricity Rules:

- (i) clause 3.18.3(a) required NEMMCO to develop auction rules that set out criteria which a person must satisfy in order to be eligible to enter into SRD Agreements with NEMMCO;
- (ii) clause 3.18.2(b) provided that NEMMCO may only enter into SRD Agreements with persons that (among other things) satisfy the criteria

² ACCC, *Final Determination: Applications for Authorisation, National Electricity Code, Settlements Residue Auction Process*, 22 December 1999, A90688, A90689 and A90690.

specified in the auction rules, which criteria must comply with clause 3.18.2(g);

(iii) clause 3.18.2(g)(2) read as follows:

(g) Any criteria specified in the *auction rules* concerning persons with whom *NEMMCO* may enter into *SRD agreements* **may only exclude** the following persons from entering into such agreements:

.....

(2) *transmission network service providers*;

[our emphasis]

Clause 3.18.2(g)(2) could be read as permitting NEMMCO to exclude Transmission Network Service Providers from entering into SRD Agreements but not compelling NEMMCO to do so.

"Transmission Network Service Provider" was defined in Chapter 10 of the National Electricity Code to mean a person who engages in the activity of owning, controlling or operating a transmission system.

"Transmission system" was defined in Chapter 10 to mean a transmission network, together with the connection assets associated with the transmission network, which is connected to another transmission system or distribution system.

"Transmission network" was defined in Chapter 10 to mean a network within any participating jurisdiction operating at nominal voltages of 220 kV and above plus:

- (a) any part of a network operating at nominal voltages between 66 kV and 220 kV that operates in parallel to and provides support to the higher voltage transmission network; and
- (b) any part of a network operating at nominal voltages between 66 kV and 220 kV that is not referred to in paragraph (a) but is deemed by NECA to be part of the transmission network.

(b) Effect of current version of clause 3.18.2(g)(2) under the National Electricity Rules

When the National Electricity Code was replaced by the National Electricity Rules:

- (i) clauses 3.18.3(a) and 3.18.2(b) remained unchanged;
- (ii) aside from the reference to NECA being changed to refer to the Australian Energy Regulator (**AER**), the definitions of Transmission Network Service Provider, transmission system and transmission network remained unchanged in substance;
- (iii) the wording of clause 3.18.2(g)(2) was changed to read as follows:
 - (g) Any criteria specified in the *auction rules* concerning persons with whom *NEMMCO* may enter into *SRD agreements* **must not exclude** any persons other than those specified in paragraphs (1) – (6) below and **must exclude** the persons specified in paragraphs (1), (2), (5) and (6) below:

.....
 (2) *Transmission Network Service Providers;*

[our emphasis]

Clause 3.18.2(g)(2) now compels NEMMCO to exclude Transmission Network Service Providers from entering into SRD Agreements.

Despite EnergyAustralia's network business being primarily a distribution business, a portion of EnergyAustralia's network is classified as a transmission system. Therefore, EnergyAustralia is a Transmission Network Service Provider and EnergyAustralia is excluded from participating in settlement residue auctions.

NEMMCO and EnergyAustralia submit that EnergyAustralia's circumstances do not warrant EnergyAustralia's exclusion from participating in settlement residue auctions.

(c) History of EnergyAustralia's status as a Transmission Network Service Provider

Historically, EnergyAustralia has been in a unique position in the NEM. Its network business is primarily a distribution business serving the Sydney, Central Coast and Newcastle regions and, prior to the commencement of the NEM, it was operated and regulated as such.

EnergyAustralia is the distributor to Australia's largest population centre and certain elements of its 132 kV network are classified under the National Electricity Rules as transmission, rather than distribution.

The definition of "transmission network" in the National Electricity Rules includes a network operating at 220 kV and above and any part of a network operating between 66 kV and 220 kV that operates in parallel to and provides support to the higher voltage network. A significant portion of EnergyAustralia's 132 kV network runs in parallel to the higher voltage network and is, therefore, taken to be a transmission network under the National Electricity Rules. EnergyAustralia does not have any assets which operate at or above 220 kV.

Initially, a jurisdictional derogation to the National Electricity Code provided that EnergyAustralia's network and associated connection assets would be treated as a distribution system until 2000. From 2000/01, the network and associated connection assets became regulated as a transmission system.

Despite its network business primarily being a distribution business, from 1 February 2000 (National Electricity Code clause 9.18.1) EnergyAustralia also became a Transmission Network Service Provider. Today, EnergyAustralia remains a Distribution Network Service Provider and a Transmission Network Service Provider under the National Electricity Rules.

EnergyAustralia executed an Auction Participation Agreement with NEMMCO on 25 May 2000 and commenced participating in settlement residue auctions in March 2001.

3.3 Detailed discussion of policy issues to support EnergyAustralia's inclusion

EnergyAustralia has submitted that the following policy issues support this request for the Participant Derogation.

(a) EnergyAustralia's role as a retailer

EnergyAustralia is the largest electricity retailer in NSW. EnergyAustralia submits that it is important for its efficiency and competitiveness as a retailer, and to maximise value for its retail customers, that EnergyAustralia has access to the full range of potential hedging transactions to reduce the significant financial risks borne by retailers trading in the NEM.

The ability to participate in settlement residue auctions, while not the main source of hedging, forms an important component of EnergyAustralia's spot market risk minimisation strategy.

Competitive neutrality and the interests of its customers require that EnergyAustralia has the same access to settlement residue auctions as other retailers against whom it competes.

(b) Ability of EnergyAustralia's transmission network to affect settlements residue

There are two key attributes of the part of EnergyAustralia's network that constitutes a transmission system that are relevant:

- (i) Most of it is located between Sydney North, Sydney South, Beaconsfield West and the coastline. There are also a couple of circuits on the Central Coast. All of these areas are contained within EnergyAustralia's distribution district. As can be seen from the maps in Attachment 1, EnergyAustralia's distribution district and, therefore, the part of its network that constitutes a transmission system are a long way from the boundary between the NSW region and the other NEM regions.
- (ii) As mentioned, EnergyAustralia's 132 kV network runs in parallel to TransGrid's network and essentially serves as a back-up to TransGrid's network. EnergyAustralia does not have any assets which operate at or above 220 kV.

EnergyAustralia submits that the location and role of its transmission system means that it cannot operate its transmission system in a way that would have any material impact on the value of the settlements residue.

More specifically, despite its size, EnergyAustralia submits that the switching of its transmission system does not have any material impact on spot market outcomes. Generators would continue to be dispatched according to the National Electricity Rules and could not be materially constrained off by EnergyAustralia. EnergyAustralia is not aware that any of the elements of its transmission system form part of the constraint envelope used by NEMMCO in dispatch calculations.

NEMMCO confirms that its analysis supports EnergyAustralia's submission that EnergyAustralia's transmission system cannot materially impact on spot market outcomes and does not form a material part of NEMMCO's constraint envelope.

(c) Policy rationale for excluding entities from participating

NEMMCO and EnergyAustralia understand that the original policy rationale for NEMMCO being able to exclude Transmission Network Service Providers from settlement residue auctions was to exclude the entities which owned assets that could be used to manipulate the value of the settlements residue. This can be seen from the ACCC's Final Determination authorising the introduction of clause 3.18.2(g)

into the National Electricity Code.³ The following passages of that determination are particularly pertinent:⁴

"The limits on participation in the SRA process are intended to ensure that parties do not unfairly capture the benefits of the settlements residue auction proceeds because of their ability to influence the settlements residue.

...

The Commission considers that the exclusion of this category of participant [transmission network service providers] will enhance the public benefits arising from the conduct of the settlements residue auctions. This is because it will enable the residue to be made available to parties that wish to utilise the hedging properties of the IRSR, rather than allowing the IRSR to be bought by those that are well placed to influence its future value.

TNSPs 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 upon the residue outcome.

...

The Commission considers that where a TNSP has established business activities which stand apart from the provision of prescribed transmission network services, such as market network services, then subject to meeting the ring fencing requirements set out in the Commission's *Draft Statement of Principles for the Regulation of Transmission Revenues*, the service provider should not be prevented from participating in auctions relating to such services."

[our emphasis]

On the basis of EnergyAustralia's submission that it cannot influence the value of settlements residue, NEMMCO and EnergyAustralia submit that the original policy of the former National Electricity Code is not served by preventing EnergyAustralia from participating in settlement residue auctions. As far as NEMMCO and EnergyAustralia are aware, the original policy intent remains relevant in respect of clause 3.18.2(g)(2) of the National Electricity Rules.

Further, the proposed definition of **Participant Derogation Expiry Date** enables the Participant Derogation to cease to apply if EnergyAustralia becomes capable of influencing settlements residues. In particular, the Participant Derogation will expire upon EnergyAustralia 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), is capable of having a material impact by reducing the interconnector capability. This has been selected as an objective criterion for identifying if EnergyAustralia could be considered to have transmission

³ ACCC, *Final Determination: Applications for Authorisation, National Electricity Code, Settlements Residue Auction Process*, 22 December 1999, A90688, A90689 and A90690.

⁴ Pages 14-15.

assets that are capable of having a material impact on the interconnectors and thus the settlements residue.⁵

In essence, this criterion states that a material inter-network impact occurs if there is a change in power transfer capability between transmission networks or in another transmission network of more than 3% of capability or 50 MW. NEMMCO has confirmed that EnergyAustralia's transmission assets do not have a material inter-network impact according to this criterion. NEMMCO and EnergyAustralia submit that this is a workable criterion that removes the need for the exercise of any discretion.

(d) Ring fencing

The ACCC has issued a notice under section 11 of the Transmission Ring Fencing Guidelines to waive any requirement for EnergyAustralia's transmission business to be contained in a separate legal entity to its other businesses. The ACCC's reasons for doing so included the lack of public benefit in enforcing such a requirement, the significant costs of compliance and the existence of separate ring fencing of EnergyAustralia's distribution and retail businesses which is imposed by the Independent Pricing and Regulatory Tribunal of New South Wales (**IPART**). EnergyAustralia is subject to the other requirements under the Transmission Ring Fencing Guidelines.

In any event, EnergyAustralia submits that the issue of ring fencing is not relevant to EnergyAustralia because EA cannot operate its transmission system in a way that would have any material impact on the value of the settlements residue. As such, there is no offending component of EnergyAustralia's business which materially impacts on the settlements residue and which, in the context of settlement residue auctions, needs to be the subject of ring fencing.

3.4 How the issue will be addressed

As discussed in section 2 above, it is proposed to include the following Participant Derogation in Chapter 8A of the National Electricity Rules:

For the purpose of clause 3.18.2(g)(2), the reference to *Transmission Network Service Providers* is deemed to exclude EnergyAustralia (ABN 67 505 337 385).

If the above Participant Derogation is made by the AEMC, NEMMCO will cease to be required to specify criteria in its Auction Rules which exclude EnergyAustralia from participating in settlement residue auctions.

NEMMCO will then be able to make appropriate amendments to the Auction Rules (and will need to do so). The Auction Rules currently require that NEMMCO exclude Transmission Network Service Providers from participation in settlement residue auctions. NEMMCO proposes to amend the Auction Rules in accordance with the process set out in National Electricity Rule 3.18.3 so that the Auction Rules will not prevent EnergyAustralia's participation in settlement residue auctions.

The Auction Participation Agreement between NEMMCO and EnergyAustralia enables NEMMCO to terminate the Auction Participation Agreement and any SRD Agreements if EnergyAustralia does not meet the criteria set out in the Auction Rules. If the Auction Rule criteria are changed, it may not be necessary to amend the Auction Participation

⁵ The criteria that have been determined by the IRPC are published on NEMMCO's website at: http://nemmco.com.au/transmission_distribution/170-0035.pdf.

Agreement. NEMMCO and EnergyAustralia will consider whether any amendments are necessary, and if so, make the amendments by written agreement. However, NEMMCO will retain the right to terminate the Auction Participation Agreement and any SRD Agreement with EnergyAustralia immediately if the Participant Derogation expires because EnergyAustralia is capable of influencing settlements residue. EnergyAustralia will not be permitted to retain the rights to settlement residue units which, although it may not have been able to do so at the time of purchase, EnergyAustralia is capable of influencing at the time the value of settlements residue is determined.

4. How the proposed Rule will contribute to the NEM objective

[Refer Regulation 8(1)(d).]

4.1 The objective of the National Electricity Market

Clause 7 of the National Electricity Law provides that the NEM objective is:

"to promote efficient investment in, and efficient use of, electricity services for the long term interests of consumers of electricity with respect to price, quality, reliability and security of supply of electricity and the reliability, safety and security of the national electricity system."

4.2 Contribution to the objective of the National Electricity Market

EnergyAustralia submits that the proposed Participant Derogation will promote the NEM objective because by allowing the largest retailer in NSW to participate in settlement residue auctions in circumstances where other retailers have access to settlement residue auctions:

- (a) from the perspective of the end-use consumer:
 - (i) it will provide the largest retailer in NSW with access to the full range of potential hedging transactions to reduce the significant financial risks borne by retailers trading in the NEM;
 - (ii) this access will enable EnergyAustralia to have electricity costs that reflect the entire range of transactions available in the market; and
 - (iii) EnergyAustralia will be able to reflect these costs in the prices that it charges to end-use consumers who will then be able to make economically rational consumption decisions based on the costs they face; and
- (b) from the perspective of the Network Service Providers who ultimately receive the proceeds from each auction:
 - (i) by allowing the largest retailer in NSW the right to participate in settlement residue auctions, it will enable the prices bid for settlement residue units to reflect their real value to the market, thus ensuring that the proceeds Network Service Providers receive from each settlement residue auction reflect the true value to the market.

As mentioned above, EnergyAustralia also considers that competitive neutrality and the interests of its customers require that EnergyAustralia has the same access to settlement residue auctions as other retailers against whom it competes.

5. Power of AEMC to make Participant Derogation

The AEMC's power to make the proposed Participant Derogation and the relevant procedure to be followed is contained in Part 7 of the National Electricity Law (sections 87 to 108, in particular section 91(1)).

EnergyAustralia submits that the subject matter of the requested Participant Derogation comes within the subject matter in respect of which the AEMC may make a Rule under the National Electricity Law (see sections 94(1)(b) and 34(1) of the National Electricity Law). Section 34(1) relevantly provides that the AEMC may make Rules for the operation of the NEM and the activities of Registered Participants.

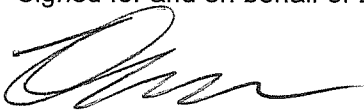
Signed for and on behalf of National Electricity Market Management Company Limited by:



Brian Spalding
Chief Operating Officer

Date: 13 April 2006

Signed for and on behalf of EnergyAustralia by:



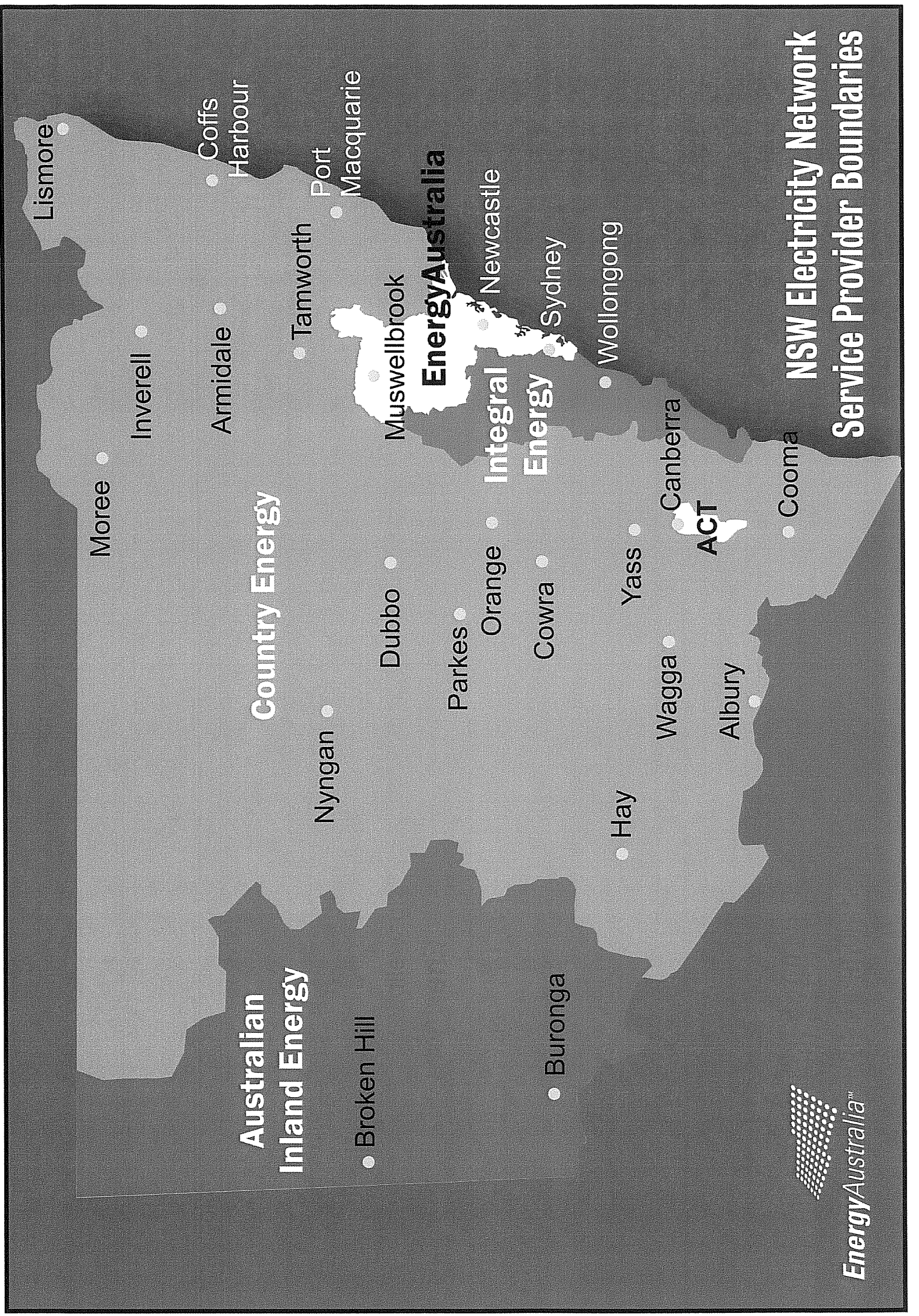
Tim O'Grady
General Manager Retail

Date: 13 April 2006

Attachment 1

Maps showing:

- The local government areas within EnergyAustralia's distribution district.
- EnergyAustralia's distribution district relative to the rest of NSW. *[Note that the area shown as "Australian Inland Energy" is now part of Country Energy's area.]*
- Map entitled "NSW Statement of System Opportunities" showing the NSW transmission system (mostly owned by TransGrid). *[Note: Due to the scale of the map, it is not possible to clearly show EnergyAustralia's transmission assets on this map.]*



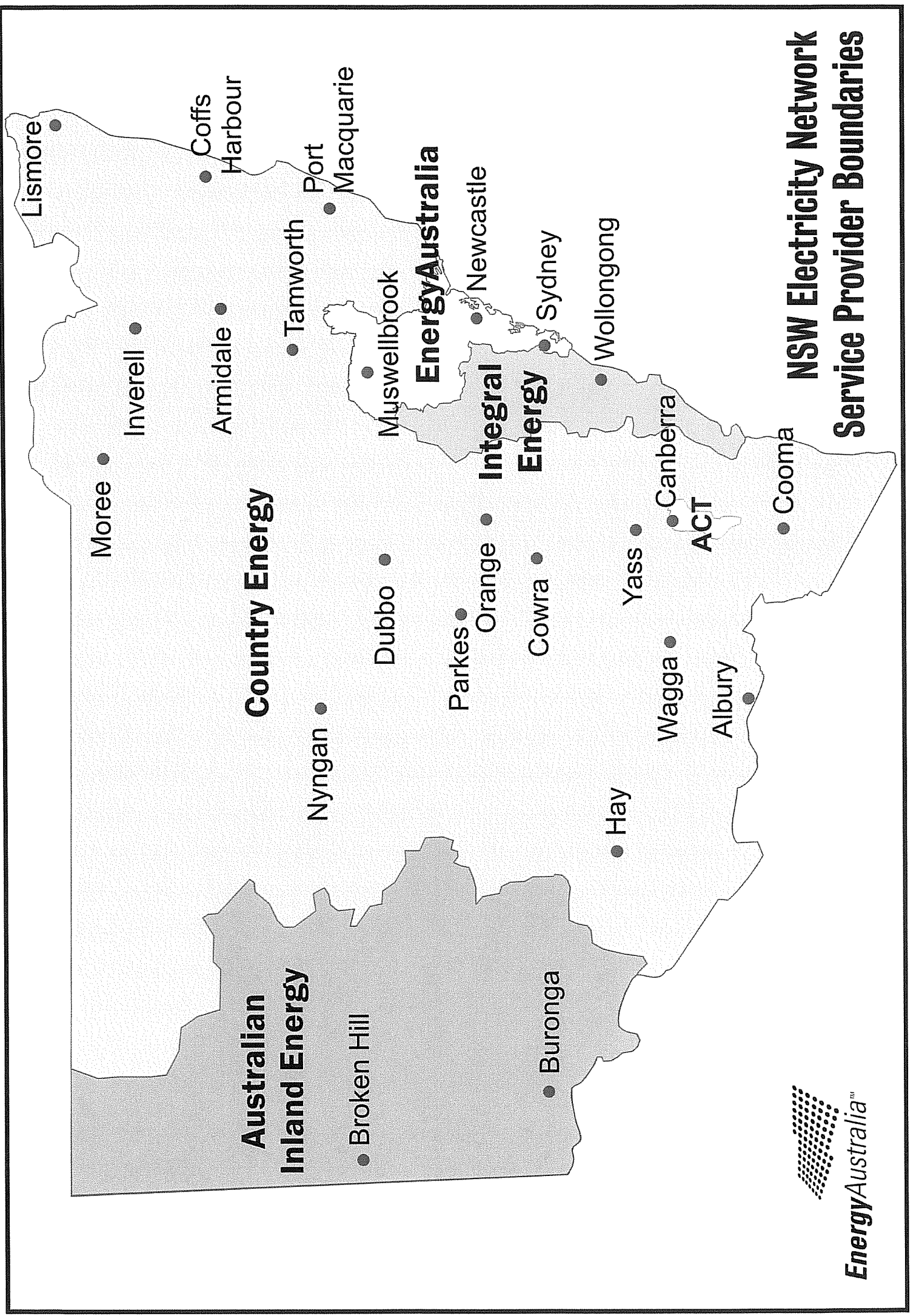
**Australian
Inland Energy**

Country Energy

EnergyAustralia



**NSW Electricity Network
Service Provider Boundaries**



Country Energy

MURRURUNDI SHIRE

Barry

GLOUCESTER SHIRE

SCONE SHIRE

Scone

Merriwa

Country Energy

Muswellbrook

DUNOGG SHIRE

MUSWELLBROOK SHIRE

Singleton

SINGLETON SHIRE

EnergyAustralia

CITY OF MAITLAND

PORT STEPHENS COUNCIL

Cessnock

CITY OF NEWCASTLE
Newcastle

CITY OF CESSNOCK

CITY OF LAKE MACQUARIE

CITY OF HAWKESBURY

WYONG SHIRE

Integral Energy

CITY OF GOSFORD

Gosford

Woy Woy

HORNSBY SHIRE

Hornsby

CITY OF BLUE MOUNTAINS

Katoomba

BAULKHAM HILLS SHIRE

CITY OF BLACKTOWN

CITY OF PENRITH

CITY OF PARRAMATTA

CITY OF FAIRFIELD

CITY OF LIVERPOOL

CITY OF BANKSTOWN

Sydney

CAMDEN COUNCIL

SUTHERLAND SHIRE

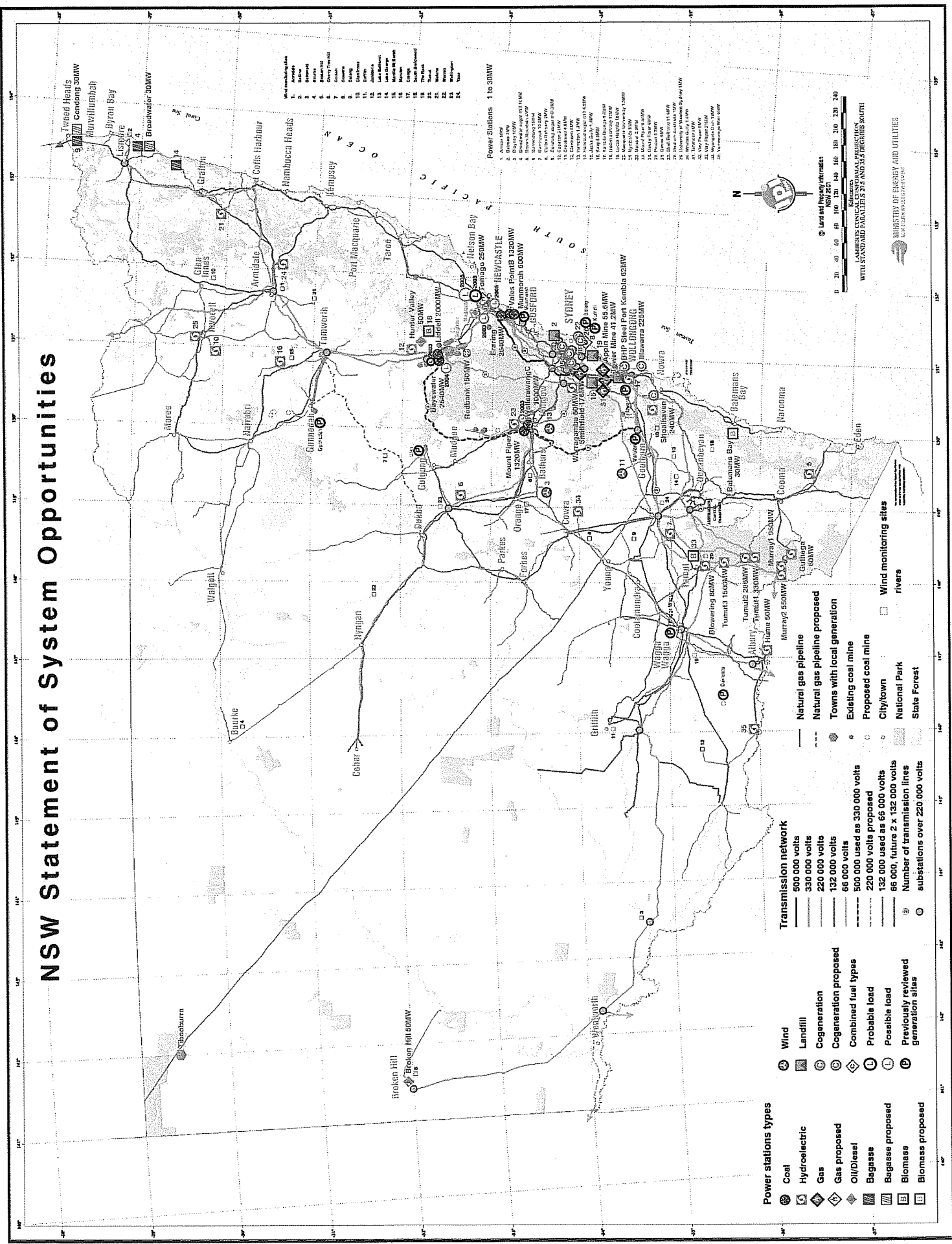
Waterfall

WOLLONDILLY SHIRE

CITY OF CAMPBELLTOWN

CITY OF WOLLONGONG

NSW Statement of System Opportunities



- Power Stations 1 to 30MW**
1. Broken Hill
 2. Bathurst
 3. Orange
 4. Sydney
 5. Newcastle
 6. Port Macquarie
 7. Tamworth
 8. Dubbo
 9. Murrumbidgee
 10. Murrumbidgee
 11. Murrumbidgee
 12. Murrumbidgee
 13. Murrumbidgee
 14. Murrumbidgee
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 23. Murrumbidgee
 24. Murrumbidgee

- Power Stations 1 to 30MW**
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 23. Murrumbidgee
 24. Murrumbidgee

- Power stations types**
- Coal
 - Hydroelectric
 - Gas
 - Gas proposed
 - Oil/Diesel
 - Bagsasse
 - Probable load
 - Possible load
 - Previously reviewed
 - Biomass
 - Biomass proposed

- Transmission network**
- 500 000 volts
 - 330 000 volts
 - 220 000 volts
 - 132 000 volts
 - 66 000 volts
 - 500 000 used as 330 000 volts
 - 220 000 volts proposed
 - 132 000 used as 66 000 volts
 - 66 000 used as 132 000 volts
 - Number of transmission lines
 - substations over 220 000 volts

- Natural gas pipeline
- Natural gas pipeline proposed
- Towns with local generation
- Existing coal mine
- Proposed coal mine
- City/Town
- National Park
- State Forest

- Wind
- Landfill
- Cogeneration
- Cogeneration proposed
- Combined fuel types
- Probable load
- Possible load
- Previously reviewed
- Generation sites
- Wind monitoring sites
- rivers

- Land and Property Information**
- NSW 2011 Lab 100 300 320 340
- Kilometres
- 0 70 140 210 280 350 420 490 560 630 700 770 840 910 980
- LAND SERVICES**
- LAND SERVICES CONSULTANTS 2/2 AND 2.5 DEGREES SOUTH
- MINISTRY OF ENERGY AND UTILITIES**
- NEW SOUTH WALES GOVERNMENT