

23 February 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
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Dear John,

Extension of Sunset for the Recovery of Accrued Negative Settlement Residue

NEMMCO requests the AEMC to consider extending the savings and transitional Rule regarding the National Electricity Amendment (Negative Inter-Regional Settlements Residue) Rule 2006 under sections 91 and 96 of the *National Electricity Law (NEL)*. It is proposed that the sunset date applicable to the current mechanism for recovery of negative settlement residue be extended by one year to 30 June 2010. This would provide participants with certainty that the mechanism for recovery of negative settlement residue will not revert to the approach that applied prior to July 2006, and would allow time for a managed transition to the new arrangement proposed by the AEMC as an outcome of its recent Congestion Management Review (**CMR**).

NEMMCO considers that the proposed Rule change is non-controversial as it is unlikely to have a significant effect on the National Electricity Market (**NEM**), as is required for an expedited consultation process under section 96 of the NEL.

The Settlement Residue Committee (**SRC**) at its meeting on 6 February 2009 expressed support for the sunset to be extended, and requested NEMMCO to progress this Rule change proposal.

A description of the proposed Rule change, statement of the issues concerning the existing Rules, and how the proposed Rule addresses those issues consistent with the national electricity objective is contained in Attachment A. A draft of the proposed Rule is set out in Attachment B.

NEMMCO would be pleased if you could have these matters considered by the AEMC. For further details, please do not hesitate to contact Taryn Maroney on (02) 8884 5609.

Yours faithfully,



Murray Chapman
Acting General Manager Market Operations

Enc. Attachment A: Requests for Rule change
Attachment B: Draft version of the proposed Rule

ATTACHMENT A

1. Statement of issues

This section identifies the issues and relevant background regarding the recovery of accrued negative inter-regional settlements residue (**IRSR**). NEMMCO's proposed solution to this issue is also discussed.

1.1 Background

Inter-Regional Settlements Residue

IRSR can occur as a result of spot market inter-regional trading and is caused by a particular combination of price differences between regions and inter-regional power flows. It is generally:

- positive, when electricity flows from a lower-priced *region* to a higher-priced *region*; and
- negative, when electricity flows from a higher-priced *region* to a lower-priced *region* (a Counter-Price Flow).

Specifically, negative IRSR is recovered from positive IRSR arising in the same billing period.¹ If the net of positive and negative IRSR amounts is negative for the billing period, the Rules provide different recovery arrangements, depending on whether the negative IRSR arose before or after 30 June 2009. NEMMCO may recover net negative IRSR arising:

- before the end of 30 June 2009 from future auction proceeds.²
- after the end of 30 June 2009 from future auction fees.³

Negative Inter-Regional Settlements Residue Rule 2006

Prior to the Negative Inter-Regional Settlements Residue Rule 2006, negative IRSR were recovered from future auction fees rather than auction proceeds under clause 3.6.5(4) of the Rules. This change reduced:

- the cost of funding of negative residue debt
- cross subsidies that occurred between current auction participants and future ones.

These cross subsidies occurred because the previous recovery method used to take up to three years to fully recover negative IRSR accrued today. Therefore, settlements residue auction (**SRA**) unit holders were paying for market outcomes that occurred up to three years earlier.

At the time of making this Rule, the AEMC noted a number of issues raised by participants concerning the SRA and inter-regional financial trading arrangements in the national electricity market (**NEM**) and indicated that these would be more appropriately addressed in the Congestion Management Review (see below section). Consequently, the AEMC included

¹ A billing period begins with the first trading interval on a Sunday and ends on with the last trading interval on a Saturday.

² See clause (a)(4A) and 11.1.1(c) of the Rules.

³ See clause 3.6.5(a)(4) of the Rules.

a sunset clause into the Rules which was intended to limit "...the application of this new regime to three years from its commencement."⁴ Hence, these provisions (particularly rule 11.1) were included with the intention of providing stakeholders the opportunity to consider longer term solutions.

Congestion Management Review

On 5 October 2005, the Ministerial Council on Energy (**MCE**) directed the AEMC to review congestion management in the NEM. The AEMC published the Final Report of the Congestion Management Review (**Final Report**) on the 16 June 2008. The Final Report included four draft Rule changes for managing financial and physical trading risks associated with transmission network congestion. One of these, the Draft National Electricity Amendment (Negative Inter-Regional Settlements Residue Amounts) Rule 2008 (**Negative Residue Draft Rule**), included proposed amendments to the Rules concerning the funding of negative settlement residues.

In November 2008, the MCE endorsed the recommendations in the AEMC's Final Report and noted that the current recovery mechanism was due to expire on the 30 June 2009. The MCE considered that:

...it would be inefficient to revert to the old recovery mechanism of auction fees and therefore the current sunset should, if necessary, be extended until the new recovery mechanism can be implemented. This should be given effect through a savings and transitional arrangement in the Negative Residue Draft Rule.⁵

1.2 The Issue with the Current Provisions

If the current provision is allowed to expire on the 30 June 2009, NEMMCO will be required to recover outstanding negative IRSR from future auction fees. As discussed above, this method was used prior to the Negative Inter-Regional Residue Rule 2006. NEMMCO considers that it would be inefficient to revert back to this method because:

- The AEMC is expected to commence consultation on the Negative Residue Draft Rule shortly which proposes a longer term mechanism for the recovery of negative settlement residues;
- It would increase the cost of funding negative residue debt to NEMMCO due to the need to finance accrued residues;
- It would increase the potential for cross subsidies between current SRA participants and future participants; and
- transitional complexities involved in reverting to the old method would be introduced unnecessarily, prior to the introduction of the new approach proposed by the AEMC in their Final Report.

NEMMCO also notes that the approaching sunset provides a very limited time for NEMMCO to manage the transition to the method proposed in the AEMC's Final Report. The design of transitional arrangements such as the development of new systems and

⁴ AEMC, *Rule Determination: National Electricity Amendment (Negative Inter-regional Settlements Residue) Rule 2006*, p 2.

⁵ MCE, *Congestion Management Review: Ministerial Council on Energy Response to Australian Energy Market Commission Final Report*, November 2008, p. 3.

processes will only become clear when the new Rule is finalised, at which time the sunset will be very close, potentially leaving inadequate time for a properly managed transition.

NEMMCO also notes the MCE's view that reverting back to recovering negative IRSR from auction fees would be inefficient and, if necessary, the sunset provision should be extended until the new recovery method could be implemented. The MCE expected that this should be given effect through a savings and transitional arrangement in the Negative Residue Draft Rule.⁶ Since this has not yet occurred, NEMMCO considers it necessary to address this issue.

NEMMCO discussed these matters with the Settlement Residue Committee (**SRC**) at its meeting on 6 February 2009. The SRC indicated that as consultation on the recommendations of the Final Report had not yet commenced, it was concerned that the approaching sunset created uncertainty for participants as to how negative IRSR would be managed in the future. Accordingly, the SRC requested NEMMCO to progress a Rule change proposal to extend the sunset provision by 12 months.

2. Proposed Rule

This section provides a description of the proposed Rule developed by NEMMCO, NEMMCO's right to submit the proposed Rule changes to the AEMC, and the power that NEMMCO considers that the AEMC has to consider this proposed Rule change.

2.1 Description of Proposed Rule

The proposed Rule seeks to extend the expiration date of the current recovery method for accrued negative settlements residue to the 30 June 2010.

2.2 NEMMCO's Right to Submit this Proposal

NEMMCO is requesting that the AEMC make this proposed Rule in accordance with section 91 of the NEL.

NEMMCO has the following relevant functions under the NEL:

- to operate and administer the NEM; and
- to promote the development and improve the effectiveness of the operation and administration of the NEM.

Under section 91(1) of the NEL, the AEMC may make a Rule at the request of any person, the MCE or the Reliability Panel. As such, NEMMCO may request the AEMC make a Rule.

2.3 Power of the AEMC to Make the Proposed Rule

The subject matter about which the AEMC may make Rules is set out in section 34 and Schedule 1 of the NEL.

NEMMCO considers that the proposed Rule falls within the subject matters that the AEMC may make Rules about. The proposed Rule is within the matters set out in part 34 of Schedule 1 to the NEL, as it relates to the payment of money (including interest) for the settlement of transactions for electricity services purchased or supplied through the wholesale exchange operated and administered by NEMMCO.

⁶ MCE, *Congestion Management Review: Ministerial Council on Energy Response to Australian Energy Market Commission Final Report*, November 2008, p. 3.

2.4 Request for a Non-Controversial Rule

NEMMCO requests that the AEMC considers this Rule change proposal under section 96 of the NEL. Section 96 applies if the AEMC considers that a request for a Rule is a request for a non-controversial Rule. A non-controversial Rule means a Rule that is unlikely to have a significant effect on the NEM.

NEMMCO considers that section 96 applies to this proposal as the Rule would not have a significant impact on the market because it only extends the expiration date of the current arrangement until the expected Rule changes to this matter are finalised.

3. How the proposed Rules contribute to the National Electricity Objective (NEO)

Before the AEMC can make a Rule change it must apply the rule making test set out in the NEL, which requires it to assess whether the proposed Rule will or is likely to contribute to the NEO. Section 7 of the NEL states the 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, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

NEMMCO submits that the proposed Rule promotes good regulatory practice because it increases regulatory certainty while the arrangements for the treatment of negative IRSR are finalised by the AEMC. Further, extending the existing arrangements would avoid the increased costs associated with debt financing and cross-subsidisation that would occur as a result of reverting to the previous method of recovery.

4. Expected Benefits and Costs of the Proposed Rule

Given the proposed Rule extends the existing arrangement; NEMMCO does not expect any party would be required to outlay implementation costs as a result of this Rule change.

GLOSSARY

Term or Abbreviation	Explanation
AEMC	Australian Energy Market Commission
IRSR	Inter-Regional Settlements Residue
MCE	Ministerial Council on Energy
NEM	National Electricity Market
NEO	The national electricity objective as stated in section 7 of the NEL.
NEL	National Electricity Law
Rules	National Electricity Rules
SRA	Settlements Residue Auction
SRC	Settlement Residue Committee

ATTACHMENT B

This Draft is based on National Electricity Rules Version 25

- 3.6.5 (c) Subject to clauses 11.1.1 and 11.1.2:
- (i) clause 3.6.5(a)(4) does not have effect during the period commencing on 1 July 2006 and ending at the last moment of 30 June 2010 ~~2009~~ but comes into effect again at the end of that period; and
- 11.1.1 (c) Clause 3.6.5(a)(4A), as in force immediately before 30 June 2010 ~~2009~~, continues to apply to any *negative settlements* residue amounts arising on or after 1 July 2006 but before 30 June 2010 ~~2009~~, and not recovered as at 30 June 2010 ~~2009~~, until all such negative amounts have been recovered.
- 11.1.2 (b) Clause 3.6.5(a)(4B), as in force immediately before 30 June 2010 ~~2009~~, continues to apply to any interest costs arising on or after 1 July 2006 but before 30 June 2010 ~~2009~~, and not recovered as at 30 June 2010 ~~2009~~, until all such interest costs have been recovered.