



Secondary Trading Of Settlement Residue Distribution Units

Publication of final rule determination and final rule

The Australian Energy Market Commission (AEMC) has made a final rule that enables auction based secondary trading of settlements residue distribution units.

This final rule is designed to enable the Australian Energy Market Operator (AEMO) to provide a platform for secondary trading of settlements residue distribution units (units). Secondary trading improves liquidity in the market for units. This improved liquidity is likely to increase interstate trade of electricity, improve risk management and increase competition in retail and wholesale markets.

The final rule allows for, but does not mandate the introduction of secondary trading of units via the same auction process already facilitated by AEMO. The final rule also implements a specific risk mitigation measure for seller default risk.

Settlements residue auctions and secondary trading

Regions of the national electricity market (NEM) have different levels of demand, differently priced generation and often very different wholesale prices resulting from the use of regional reference prices. Price separation of regional reference prices often occurs when interconnector capacity is not sufficient to equalise the spot price flowing from a lower to a higher priced region.

The difference between the price paid in the importing region and the price received in the exporting region, multiplied by the amount of flow for each interconnector for a trading interval, results in surplus inter-regional settlements residue.

Since August 1999, AEMO and its predecessor, the National Electricity Market Management Company (NEMMCO) have been holding auctions where units, representing a right to a certain portion of that money could be purchased by auction participants.

While the settlements residue is distributed among successful auction participants proportionally to the number of units they have purchased, AEMO forwards the auction proceeds to the transmission network service provider (TNSP) located in the importing regions. As the TNSP's regulated revenue is set, all else being equal, the auction proceeds result in decreased network charges for the TNSP's customers.

Currently, units purchased at AEMO auctions may be traded bilaterally among auction participants, but secondary trading is not permitted through the auction process. This is because the National Electricity Rules (NER) only allow AEMO to pay auction proceeds to the TNSPs and not to auction participants.

The final rule

The final rule, which is a more preferable rule, addresses the same issues as Westpac's proposed rule, but takes a different approach with regards to consequences of counterparty default in the secondary market.

The final rule:

- enables auction participants to offer their previously purchased units for sale at subsequent auctions facilitated by AEMO
- requires AEMO to distribute auction proceeds to either the relevant TNSP or auction participant, as the case may be
- requires secondary sellers to provide a margin at the same time as they submit offers to the auction. In case of a default, AEMO must apply that margin to the amounts owing to AEMO by the defaulting party

The final rule enables AEMO to provide a platform for secondary trading of settlements residue distribution units.

- requires TNSPs to be responsible for any shortfall in auction proceeds payable to the secondary sellers arising from a buyer default.

A more liquid market for inter-regional settlements distribution units is likely to offer better protection against price separation between regions and lead to more efficient inter-regional hedging outcomes. If hedging outcomes in the wholesale market become more efficient, that will result in lower electricity prices for consumers.

Consumers also benefit where risks are allocated to the parties that have the information, ability and incentives to best manage the counterparty risks. Secondary sellers are the appropriate party to provide assurance against their own default.

The rule change request

Westpac proposed to amend the NER to allow AEMO to distribute the relevant portion of the auction proceeds to the sellers of units.

This included amending the NER to allow:

- auction participants to offer units for sale at AEMO auctions
- AEMO to pay for those units, cancel them and offer them for sale again
- AEMO to distribute part of the auction proceeds to the sellers of units
- AEMO to recover money from TNSPs, if payments fall short because of an auction participant default.

Westpac considered that these changes will provide a number of benefits, including:

- anonymous trading
- increased liquidity
- simplified execution of trades
- reduced default, credit and settlement risk for auction participants
- increased ability to optimise risks created by a changing portfolio.

Commencement

The final rule will commence on 20 October 2017.

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