

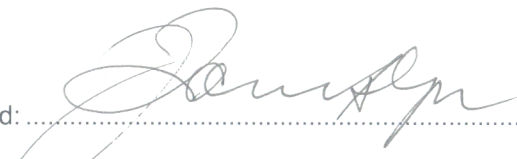
Australian Energy Market Commission

**Rule Determination**

**National Electricity Amendment (Registration  
of foreign based persons and corporations as  
Trader class participants) Rule 2007**

Rule Proponent  
BP Energy Asia Pte Limited

20 December 2007

Signed: .....

**John Tamblyn**  
**Chairman**  
For and on behalf of  
Australian Energy Market Commission

**Commissioners**  
Tamblyn  
Carver  
Woodward

## **Inquiries**

The Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

**E:** [aemc@aemc.gov.au](mailto:aemc@aemc.gov.au)

**T:** (02) 8296 7800

**F:** (02) 8296 7899

## **Citation**

AEMC 2007, Registration of foreign based persons and corporations as Trader class participants, Rule Determination, 20 December 2007, Sydney

## **About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

This work is copyright. The Copyright Act 1968 permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

# Contents

Contents .....	iii
Abbreviations .....	iv
Summary .....	v
1 BP Energy Asia's Rule proposal .....	1
2 Rule determination.....	3
2.1 The Commission's power to make the Rule .....	3
2.2 Assessment of the Rule: the Rule making test and the National Electricity Market objective.....	3
2.3 MCE statement of policy principles.....	4
2.4 Consultation on the BP Energy Asia proposal.....	5
2.5 Differences between the proposed Rule and the Rule to be made.....	5
3 Matters arising from consultation and the Commission's analysis .....	7
3.1 Recovery of outstanding fees and charges .....	7
3.2 Compliance monitoring and enforcement .....	12
3.3 Jurisdiction .....	14
3.4 Service of process .....	14
3.5 Rule change proposal vs participant derogation.....	15
3.6 Implementation.....	16
3.7 The relevance of an Australian Financial Services Licence .....	17

## Abbreviations

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
AFSL	Australian Financial Services Licence
APA	Auction Participation Agreement
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
Commission	see AEMC
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
OTC	Over-the-counter contract
PJM	Pennsylvania-(New) Jersey-Maryland
Rules	National Electricity Rules
S&P	Standard & Poors
SFE	Sydney Futures Exchange
SRA	Settlement Residue Auction
SRDA	Settlement Residue Distribution Agreement

## Summary

The Australian Energy Market Commission makes this Rule determination and attached National Electricity Amendment (Registration of foreign based persons and corporations as Trader class participants) Rule 2007 No. 10 on BP Energy Asia's proposal relating to the registration of foreign based persons and corporations as Trader class participants in accordance with sections 102 and 103 of the National Electricity Law (NEL). This Rule will commence operation on 1 January 2008.

On 4 July 2007, the Commission received a Rule change proposal from BP Energy Asia seeking the registration of foreign based persons and corporations as Trader class participants in the National Electricity Market (NEM). The Rule change proposal proposes that persons seeking to register with the National Electricity Market Management Company (NEMMCO) as a Trader do not have to meet the requirement under clause 3.3.1(a) of the Rules to be resident in, or have a permanent establishment in, Australia (ie foreign based Traders). This will enable such participants to participate in Settlement Residue Auctions.

BP Energy Asia advises that it currently trades in electricity financial derivatives in relation to the NEM through both over-the-counter contracts with NEM participants and futures contracts through the Sydney Futures Exchange. However, to remain competitive in this derivatives market and to provide a commercial basis for its continued participation in that market, BP Energy Asia contends that it needs to be capable of dealing with all products available to its competitors, including settlement residue auctions.

Under the current Rules, to participate in these auctions BP Energy Asia needs to be registered as a Trader with NEMMCO to be able to enter into auction participation agreements and settlement residue distribution agreements.

On 19 July 2007, the Commission published a section 95 notice commencing first round consultation on the Rule change proposal. The Rule change was open for public consultation for four weeks, with submissions closing on 20 August 2007. The Commission received one submission from NEMMCO and a supplementary submission from BP Energy Asia.

On 18 October 2007, the Commission published its draft Rule determination and draft Rule under section 99 and a notice commencing second round consultation on the Rule change proposal. Submissions closed on 30 November 2007. The Commission received one submission on the draft Rule determination and draft Rule in the second round of consultation.

In considering whether this proposal meets the NEM objective, the Commission is mindful of the need to balance the risks identified in submissions and its own analysis against the possible benefits from increasing competition and the potential for efficient price outcomes in the market. The Commission has assessed the benefits of creating greater depth in the settlement residue auction market by allowing foreign based Traders to participate. The Commission has also assessed the risks associated with foreign based Traders, particularly the increased difficulty in taking legal action.

To this end, the Commission has amended the proposed Rule in order to develop a Rule which would make it easier for foreign based Traders to participate in settlement residue auctions. The Rule aims to also give NEMMCO (and other Registered Participants) an avenue for legal recourse in the event of a defaulting foreign based Trader, which the Commission considers to be the main risk to the NEM from allowing foreign based Traders to participate in settlement residue auctions. The Rule seeks to ensure that arrangements exist for foreign based Traders to participate in settlement residue auctions, similarly to local based Traders.

The Rule accepts BP Energy Asia's proposal to remove the requirement for Traders to be resident in, or have a permanent establishment in, Australia, with the objective to facilitate the participation of foreign based persons and corporations as Traders in the NEM. The Rule also includes some safeguards to manage the risks, particularly in relation to enforcing non-compliance with the auction participation agreement and the settlement residue distribution agreement, by requiring a Trader to have a local office and a local agent. The Commission considers the Rule is likely to contribute to the promotion of the NEM objective and that it satisfies the Rule making test under section 88 of the NEL.

The Commission has, therefore, determined to make this Rule determination and accompanying Rule under sections 102 and 103 of the NEL. This Rule determination sets out the reasons of the Commission in accordance with the requirements of the NEL and sets out the Commission's assessment of this proposal.

## 1 BP Energy Asia's Rule proposal

On 4 July 2007, the Commission received a Rule change proposal from BP Energy Asia Pte Limited seeking the registration of foreign based persons and corporations as Trader class participants in the National Electricity Market (NEM). The Rule change proposes that persons seeking to register with the National Electricity Market Management Company (NEMMCO) as a Trader do not have to meet the requirement under clause 3.3.1(a) of the Rules to be resident in, or have a permanent establishment in, Australia. This will enable such participants to participate in settlement residue auctions.

BP Energy Asia proposes that clause 2.5A(b) of the Rules be modified in a manner similar to the following:

“A person who is registered by NEMMCO as a *Trader* is:

- ...(2) to be treated as a *Market Participant* for the purposes of clause 3.3.1 and clause 3.15 (as applied and modified by clause 3.18.4) provided that a person who is registered by NEMMCO as a *Trader* is not to be regarded as a *Market Participant* for the purposes of clause 3.3.1(a) and clause 3.15.1(b); and...”

where clause 3.3.1(a) states that “each *Market Participant* must whilst participating in the *market*... be resident in, or have a permanent establishment in, Australia”.

BP Energy Asia advises that it currently trades electricity financial derivatives relating to the NEM through both over-the-counter contracts (OTCs) with NEM participants and futures contracts through the Sydney Futures Exchange. However, to remain competitive in this derivatives market and to provide a commercial basis for its continued participation in that market, BP Energy Asia contends that it needs to be capable of dealing with all products available to its competitors, including settlement residue auctions.

To participate in these auctions, BP Energy Asia needs to be registered as a Trader with NEMMCO to be able to enter into auction participation agreements and settlement residue distribution agreements<sup>1</sup>.

Under the Rules, to be eligible to register as a Trader, the person or corporation, “must whilst participating in the market, be resident in, or have a permanent establishment in, Australia”<sup>2</sup>. As BP Energy Asia is incorporated and resident in Singapore, it is unable to satisfy this requirement. However, BP Energy Asia advises that in all other respects, it would be in a position to register as a Trader and therefore participate in settlement residue auctions.

---

<sup>1</sup> Clause 3.18.2(b) of the National Electricity Rules.

<sup>2</sup> Clause 3.3.1(a) of the National Electricity Rules.

BP Energy Asia also contends that as an active participant in the electricity financial derivatives market, it contributes to the liquidity and depth of that market.

BP Energy Asia also requested, as part of its proposal, that the Commission expedite the making of the proposed Rule on the grounds that it is a non-controversial Rule. BP Energy Asia stated that the proposed Rule is unlikely to have a significant effect on the market as the settlement residue auctions are not a core aspect of the NEM and increasing the number of potential participants in those auctions will not have a material effect on power system security or administration of the wholesale energy exchange.



## **2 Rule determination**

The Commission has determined in accordance with section 102 of the National Electricity Law (NEL) to make, with amendments, this Rule Determination and in accordance with section 103, the Rule. The Rule to be made (the Rule) is attached to this determination. The Rule will commence operation on 1 January 2008.

This determination sets out the Commission's reasons for making the Rule. The Commission has taken into account:

- the Commission's powers under the NEL to make the Rule;
- the proponent's Rule change proposal and proposed Rule;
- submissions received; and
- the Commission's analysis as to the way(s) in which the Rule is likely to contribute to the achievement of the National Electricity Market (NEM) objective so that it satisfies the statutory Rule making test.

The Commission has applied the statutory Rule making test and, for reasons set out in Chapter 3 of this Rule determination, is satisfied that the Rule, as amended, is likely to contribute to the achievement of the NEM objective.

### **2.1 The Commission's power to make the Rule**

The Commission is satisfied that the Rule proposed by BP Energy Asia falls within the subject matters for which the Commission may make Rules, as set out in section 34 of the NEL and in Schedule 1 to the NEL.

The proposed Rule satisfies the criteria of section 34 of the NEL, as it relates to the activities of persons participating in the NEM.

In addition, the proposed Rule specifically relates to matters which the Commission may make Rules that are provided for in clause 34 of Schedule 1 of the NEL where:

- clause 34(a) states that the AEMC may make Rules with respect to the payment of money for the settlement of transactions for electricity or services purchased or supplied through the wholesale exchange operated and administered by NEMMCO.

### **2.2 Assessment of the Rule: the Rule making test and the National Electricity Market objective**

The Rule making test, as provided in section 88 of the NEL, requires the Commission to be satisfied that a Rule that it proposes to make will, or is likely to, contribute to the achievement of the NEM objective.

The test requires the Commission to consider the implications of the proposed Rule for efficient investment in, and efficient use of electricity services, in respect of price,

quality, reliability and security of supply, and reliability, safety and security of the NEM, which impact on the long term interests of end users of electricity. The Commission has applied the Rule making test to BP Energy Asia's proposal and considers that the Rule, as amended, satisfies the Rule making test.

Inter-regional trading through settlement residue auctions is an important element of the design of the NEM, as it increases the level of competition for financial risk management instruments which in turn places pressure on the price of these risk management instruments towards underlying costs.

Removing barriers in the Rules that must be satisfied by Traders who are not resident in, or have a permanent establishment in, Australia (ie foreign based Traders) to participate in settlement residue auctions should increase the participation of foreign based businesses, in turn increasing the level of competition for settlement residue units. This increased competition would improve the potential for efficient price outcomes from the settlement residue auction market, and ultimately lead to greater efficiency in the overall markets for financial hedging instruments in the NEM. The Commission considers more efficient energy market prices to be in the long term interests of end users, and therefore supports enabling foreign based Traders to participate in settlement residue auctions.

In assessing whether this proposal satisfies the NEM objective, the Commission has also considered the legal and financial risks associated with permitting foreign based Traders to participate in settlement residue auctions. The submissions received have identified potential risks in the recovery of outstanding fees and charges, compliance monitoring and enforcement, jurisdiction and service of process. The Commission is mindful of the need to balance these identified risks against the potential benefits from increasing competition and the potential for efficient price outcomes in the market. To this end, the Commission has amended the proposed Rule in order to develop a Rule which would make it easier for foreign based Traders to participate in settlement residue auctions. The Rule aims to also give NEMMCO (and other Registered Participants) an avenue for legal recourse in the event of a defaulting foreign based Trader, which the Commission considers to be the main risk to the NEM from allowing foreign based Traders to participate in settlement residue auctions.

On balance, the Commission considers the Rule which allows foreign based persons and corporations to participate as Traders in the NEM while also including some safeguards to manage the risks of such participation (by requiring a local office and agent for the Trader) is likely to contribute to the promotion of the NEM objective. For these reasons, the Commission considers that the Rule making test under section 88 is satisfied.

### **2.3 MCE statement of policy principles**

The NEL also requires the Commission to have regard to any MCE statements of policy principles in applying the Rule making test. The Commission notes that currently, there are no relevant MCE statements of policy principles relating to this proposal.

## 2.4 Consultation on the BP Energy Asia proposal

A notice under section 95 of the NEL relating to the Rule change proposal was issued by the Commission on 19 July 2007, inviting submissions from interested parties. Submissions closed on 20 August 2007. One submission from NEMMCO was received. BP Energy Asia submitted a supplementary submission on 12 September 2007 to address the concerns raised by NEMMCO in its submission. These concerns are discussed in greater detail as part of the Commission's analysis of the key issues in Chapter 3.

BP Energy Asia requested that this Rule change proposal be treated as non-controversial and undergo an expedited Rule change process, on the basis that:

- it is unlikely to have a significant effect on the NEM because settlement residue auctions are not a core aspect of the NEM, as a whole; and
- increasing the number of potential participants in settlement residue auctions will not have any material effect on power system security or administration of the wholesale energy exchange.

The Commission did not accept BP Energy Asia's request to expedite the making of the Rule as non-controversial as there was potential for the proposed Rule to have other effects on the market that had not yet been identified. The Commission considered that the standard Rule change process would ensure that a comprehensive assessment of the proposal's impact on the market was undertaken.

On 11 October 2007, given the complex issues raised by NEMMCO in its submission and BP Energy Asia's responses to these issues in its supplementary submission, the Commission considered it to be in the public interest to extend the period of time required to prepare the draft Rule determination. The Commission published a notice under section 107 of the NEL extending the publication of the draft Rule determination and draft Rule to 1 November 2007.

On 18 October 2007, the Commission published the draft Rule determination and draft Rule under section 99 of the NEL. Submissions closed on 30 November 2007. The Commission received one submission on the draft Rule determination and draft Rule in the second round of consultation, from BP Energy Asia (the proponent).

## 2.5 Differences between the proposed Rule and the Rule to be made

As discussed in Section 3 of this Rule determination, the Commission has adopted the intent of BP Energy Asia's proposed Rule, but amended the implementation of the change to the Rules to address issues that have emerged from consultation and during its analysis of the proposal.

The Commission considers the removal of the requirement for a Trader 'to be resident in, or have a permanent establishment in, Australia'<sup>3</sup> would unnecessarily expose NEMMCO and other participants in the NEM to increased legal, financial

---

<sup>3</sup> Clause 3.3.1(a) of the National Electricity Rules.

and enforcement risks. To balance these risks against BP Energy Asia's objective in submitting this Rule change proposal, to increase competition in the settlement residue auction market, the Commission proposed in the draft Rule that foreign based Traders be required to have both a registered office in Australia and appoint an agent which is authorised to accept service of process and notices on behalf of the foreign based Trader. Similarly to a local agent appointed for a foreign corporation under the *Corporations Act 2001* (Commonwealth), the local agent could also be held liable for the actions of the Trader.

In order to ensure that the requirement to appoint a local agent by a foreign based Trader under the Rules can operate effectively, the Commission made modifications to the proposed Rule. These modifications relate to requiring the local agent to be a party to the auction participation agreements and the settlement residue distribution agreements and also be liable with the Trader under those agreements.

The Commission considered these requirements incorporated into the draft Rule to be less onerous for foreign based Traders than the current requirements in the Rules while (as elaborated in Sections 3.1 and 3.2 below) providing NEMMCO with the means of managing the enforcement risks that can arise from participation by foreign based Traders in settlement residue auctions.

The Commission has not made substantive changes from the draft Rule to the Rule to be made. The Commission has made some minor enhancements to the Rule to be made to improve the consistency of wording of the Rule with the Rules generally, and to reduce redundancy in the operation of the clause. The Commission has also included a requirement on NEMMCO to amend the Auction Rules to incorporate the Rule as made by 1 September 2008. NEMMCO will have to amend the Auction Rules in accordance with the requirements in the Rules, which should have the effect of allowing foreign based Traders to participate in NEMMCO's September settlement residue auctions.

### **3 Matters arising from consultation and the Commission's analysis**

In this section, the Commission addresses a number of issues that have emerged from consultation and during its analysis.

In developing the Rule, the Commission has examined a number of issues. The range of issues include the issues that were raised in NEMMCO's submission, BP Energy Asia's supplementary submission and BP Energy Asia's second round submission. These include:

- recovery of outstanding fees and charges;
- compliance monitoring and enforcement;
- jurisdiction;
- service of process;
- Rule change proposal vs participant derogation;
- implementation; and
- the relevance of an Australian Financial Services Licence.

This section details the Commission's analysis and reasons underlying its Rule in relation to each of the issues identified above.

#### **3.1 Recovery of outstanding fees and charges**

BP Energy Asia's proposal states that:

“the requirements of paragraphs (b), (c) and (d) of clause 3.3.1 are indeed essential to the prudent management of those [financial] risks.

It is further submitted that:

- paragraphs (b), (c) and (d) of clause 3.3.1;
- the other clauses with which a Trader must comply, in particular clauses 3.15 and 3.18; and
- the provisions of the auction participation agreement (the standard version of which is set out in the auction rules), and in particular clause 6.2 of that agreement by which NEMMCO ought not to have a financial exposure to an Auction Participant,

serve adequately to manage the financial risks associated with the participation of Traders in Auctions”<sup>4</sup>.

NEMMCO raised in its submission that:

“Traders who bid successfully for settlements residue units are required to pay for their acquired units prior to distribution. Should a Trader fail to pay, NEMMCO might need to take legal action for breach of contract to recover the outstanding fees”<sup>5</sup>.

“If NEMMCO needed to take recovery action against a foreign-based Trader, it would need to balance the cost of recovery (being the cost of instigating legal action, securing judgement and then seeking enforcement overseas with its attendant costs and risks) against the benefit, which will always be the outstanding amount less the difference between party/ party and solicitor/ client legal costs.

As NEMMCO operates on a non-profit basis and with an efficiency imperative, it is unlikely that NEMMCO will be in a position to seek recovery from foreign-based Traders unless the benefits clearly outweighed the costs, and the costs and risks of recovery from foreign-based Traders are likely to be far in excess of the costs of recovery against local Traders.”<sup>6</sup>

BP Energy Asia addressed NEMMCO’s concerns in its supplementary submission by:

“recommending that the [BP Energy Asia] submission to the AEMC be considered by way of a participant derogation rather than a Rule change”<sup>7</sup>

and

“if required under a Participant Derogation, [BP Energy Asia’s] participation in any Settlement Residue Auctions could be supported by a Corporate Guarantee in favour of NEMMCO by BP Finance Plc, which is a UK based company that holds external long term credit ratings by S&P and Moody’s of AA and Aa respectively, or any other BP Group entity of similar credit rating”<sup>8</sup>.

The proposal to address the issue by way of a participant derogation rather than a Rule change is considered in Section 3.5 below.

---

<sup>4</sup> BP Energy Asia Rule change proposal, dated 19 June 2007, p5.

<sup>5</sup> NEMMCO submission, dated 20 August 2007, p1.

<sup>6</sup> NEMMCO submission, dated 20 August 2007, p2.

<sup>7</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p2.

<sup>8</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p2.

As the operator of the NEM, NEMMCO has identified some very valid concerns regarding additional financial risks it may encounter, if Traders are no longer required to 'be resident in, or have a permanent establishment in, Australia'<sup>9</sup> (ie foreign based Traders). The probability of the risks identified by NEMMCO occurring are difficult to assess and are likely to vary with the identity and financial circumstances of the foreign based Trader concerned. However, the Commission recognises that NEMMCO would be required to have processes in place to manage such risks.

NEMMCO's concerns with the recovery of outstanding fees and charges arise from its exposure between the completion of an auction and the payment of the purchase price – a maximum exposure of approximately 10 months<sup>10</sup>. For example, a foreign based Trader that has successfully bid for units in a settlement residue auction for the fourth Relevant Quarter (which requires payment of the purchase price in 10 months time) who then defaults when payment is due may, depending on the clearing price and the number of units purchased, have the potential to undermine the settlement residue auction segment of the NEM for a short period of time.

The Commission considers the main risk associated with permitting foreign based Traders to participate in settlement residue auctions are the difficulties which may arise in enforcing the payment obligations of foreign based Traders under the Rules.

In considering the requirements for the participation of foreign based companies in other Australian financial markets, the Commission examined the arrangements that the Australian Securities Exchange (ASX) applies. The ASX manages the legal risk of a foreign based company applying for ASX listing by requiring the company to be registered as a foreign corporation under the *Corporations Act 2001*. One of the consequences of being registered as a foreign corporation under the *Corporations Act* is that the company must appoint a local agent which is authorised to accept service of process in Australia on behalf of the foreign based corporation. The local agent is also personally liable for the actions of the foreign based corporation. The foreign based corporation must also have a registered office in Australia.

The Sydney Futures Exchange (SFE)<sup>11</sup> does not have any express requirement that an applicant for membership in the SFE be resident, incorporated or registered in Australia, although the SFE has a broad discretion to impose any conditions that it sees fit through the application process. However, in order to participate in the SFE Clearing operations, a foreign based company must be registered as a foreign corporation in Australia under the *Corporations Act*, unless it does not carry on business in Australia. The Commission understands that, from the SFE website<sup>12</sup>, all current members of SFE Clearing are incorporated or registered in Australia.

---

<sup>9</sup> Clause 3.3.1(a) of the National Electricity Rules.

<sup>10</sup> In accordance with section 3 of NEMMCO's Settlement Residue Auction Information Memorandum, dated 2 July 2007, p36.

<sup>11</sup> Although the SFE has merged with the ASX, the Commission understands that there are still differences in the participant process for each part of the organisation.

<sup>12</sup> The current list of SFE Clearing Participants is available on the SFE website at <http://www.sfe.com.au/content/sfe/trading/contacts/participants.pdf>.

The Commission has also examined the arrangements that apply to participants in electricity markets operated in Singapore, Great Britain and the PJM<sup>13</sup> interchange market in the United States of America. Overall, participants in these markets are not required to be resident in, or have a permanent establishment in, the jurisdiction in which the relevant market operates. However, participants in each of these markets are required to satisfy rigorous prudential requirements, which include the provision of credit support which would allow the Code administrator to recover losses in the event of a default by the participant.

The Commission believes the requirement imposed by the ASX to be the most relevant in considering an appropriate arrangement for managing the financial and legal risks associated with allowing foreign based persons and companies to trade in Australian financial markets. The ASX is an Australian financial market that permits regular participation by foreign companies and would therefore have appropriate and prudent measures in place to ensure that such participation does not impact adversely on the integrity and stability of its market. Furthermore, the volume of funds transacted over the ASX, and its proportion attributable to foreign corporations, greatly exceeds comparable measures in relation to the funds traded through settlement residue auctions. The Commission can therefore be confident that the adoption of measures similar to those of the ASX should be sufficient to address issues raised by the participation of foreign corporations in settlement residue auctions, without affecting the depth of the settlement residue auction market.

In responding to this Rule change proposal, and in taking into account NEMMCO's concerns, the intent of BP Energy Asia's proposal and the Commission's analysis of the risks and benefits, the Commission considers that an appropriate solution would be to require any foreign based Trader to have a registered office in Australia and to appoint a local agent which is authorised to accept service of process in Australia on behalf of the foreign based Trader and who also can be held liable on behalf of the Trader.

The Commission considers that this solution will minimise the risks that NEMMCO has identified by ensuring that the foreign based Trader has a presence in Australia and providing an avenue for legal recourse that NEMMCO may take against a foreign based Trader to recover any outstanding fees or charges. At the same time, these requirements are less onerous for foreign based Traders to satisfy than the requirements in the current Rules.

The Commission also notes that NEMMCO has the flexibility to amend its Auction Rules using the Rules consultation procedures, as described in clause 3.18.3 of the Rules. NEMMCO may choose to amend its Auction Rules to include any additional prudential and settlement measures that it thinks would be appropriate to apply to all Traders<sup>14</sup> or particular Traders (depending on their prudential position) to further

---

<sup>13</sup> Pennsylvania-(New) Jersey-Maryland.

<sup>14</sup> Any additional measures that differentiate between Australian and foreign based Traders would need to be mindful of the various Free Trade Agreements Australia has in place with other jurisdictions.



mitigate any broader financial risks it has identified through its experience in operating settlement residue auctions. For example, NEMMCO may consider:

- requiring Traders to pay NEMMCO for all settlement residue units they have successfully acquired on the next business day following the auction, which avoids a non-payment event later in the process when payment of the purchase price would be due in accordance with the timetable described in the Auction Rules; or
- requiring Traders to give NEMMCO a prudential guarantee at the commencement of the auction process, and prescribing the circumstances in which the guarantee would be triggered, so that those Traders who successfully bid for settlement residue units pay for their acquired units in accordance with the timetable described in the Auction Rules; or
- some other measures that NEMMCO, in consultation with the market using the Rules consultation procedures, determines would satisfactorily manage any additional financial risks.

The Commission has also included provisions in the Rule which require NEMMCO to amend its Auction Rules and associated auction participation agreement and settlement residue distribution agreement to include the local agent appointed by a foreign based Trader in any contractual arrangements, so it would bear legal responsibility on behalf of the foreign based Trader. The Commission considers that the only effective way of incorporating arrangements similar to the ASX is to ensure that the local agent is also a party to the relevant agreements. In the absence of such a requirement, no real benefit can be achieved from requiring a Trader to appoint a local agent. This is particularly in relation to the enforcement by the Australian Energy Regulator, who cannot take action against a local agent unless the agent is a “relevant participant” under the NEL, which relevantly for the purposes of this determination, requires the local agent to be a Registered Participant.

While the Commission accepts that NEMMCO has identified additional financial risks which may arise in enforcing the payment obligations of foreign based Traders, it also appreciates the intent of BP Energy Asia’s Rule change proposal, namely that increased competition in the settlements residue auction market would be advantageous for all NEM participants. As a consequence, the Commission concludes that an appropriate solution is to require any foreign based Trader to have both a registered office in Australia and appoint a local agent who can accept service on behalf of the Trader and also be held jointly and severally liable for the actions of the Trader. This, essentially, allows a foreign based Trader to be treated in the same manner as a locally based Trader.

The Commission also notes that the current Rules do not impose prudential requirements on Traders, and no such requirements are included in BP Energy Asia’s proposal, so the Commission has not addressed this issue in the Rule.

## 3.2 Compliance monitoring and enforcement

BP Energy Asia's proposal states that:

"...the only benefit to NEMMCO of paragraph (a) of clause 3.3.1 is to enable it to serve notices on a Market Participant in person and on a timely basis without leaving Australia. It is further submitted that to the extent that NEMMCO does derive a benefit from the paragraph, such benefit is not material, and in particular has no material impact on managing the financial risks associated with administering the NEM..."<sup>15</sup>.

NEMMCO raised in its submission that:

"the absence of an operational presence in one of the participating jurisdictions means that foreign-based Traders cannot be treated in the same way as local Traders"<sup>16</sup>.

BP Energy Asia addressed NEMMCO's concerns in its supplementary submission with:

"...there are few Rules obligations imposed on Traders"<sup>17</sup>.

"In the event that there are any alterations to the Rules in future, [BP Energy Asia] submits that this issue would be more appropriately considered at that stage."<sup>18</sup>

The Commission notes that a key advantage of requiring Traders to be resident in, or have a permanent establishment in, Australia is to serve legal notices and, essentially, to conveniently locate the Trader in the event that enforcement of an obligation is required. The Commission's proposed requirement that foreign based Traders have both a registered office in Australia and appoint a local agent which is authorised to accept service of process in Australia on behalf of the foreign based Trader, also addresses this need in a way which is less onerous for the foreign based corporations than the current Rules requirements.

At present, foreign based Traders are unable to meet the current Rules requirement to be resident in, or have a permanent establishment in, Australia. The amended Rule will give foreign based Traders an opportunity to participate in settlement residue auctions, with some flexibility in their arrangements while still providing an avenue for legal recourse in the event of a defaulting Trader. As the proposed requirements are similar to those required by the ASX, the Commission considers that many foreign based corporations who currently participate in the ASX will be encouraged to also participate in settlement residue auctions, thereby increasing

---

<sup>15</sup> BP Energy Asia Rule change proposal, dated 19 June 2007, p5.

<sup>16</sup> NEMMCO submission, dated 20 August 2007, p1.

<sup>17</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p1.

<sup>18</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p1.

competition in that market. The Commission considers the modifications to the Rule that seek to apply similar arrangements to the ASX cannot be seen as a barrier to foreign based participants entering the market, given that the ASX applies similar arrangements and successfully allows the participation of foreign corporations on the securities exchange.

The Commission also notes that it would be difficult, if not impossible, for the Australian Energy Regulator to investigate foreign based Traders for a breach of the Rules, unless the Traders cooperate with its investigation.<sup>19</sup> However, the Commission considers that the impact of this inability to investigate any breaches of the Rules will not have a substantial impact on the efficient operation of the rest of the NEM because Traders are limited to participating in settlement residue auctions. In this regard, the Commission considers that requiring the local agent to be a party to the auction participation agreement and also the settlement residue distribution agreement ensures that the current arrangements for managing the risks involved in settlement residue auctions for local Traders can be similarly managed (through the local agent) for foreign based Traders.

The Commission notes that although the administration of the way settlement residues are allocated and distributed are governed by the Rules, the details of the allocation and distribution methodology is determined by NEMMCO through its Auction Rules. Settlement residue distribution agreements are formed between NEMMCO and each successful participant following a settlement residue auction. The settlement residue distribution agreement is the contractual instrument between NEMMCO and relevant parties, and as a consequence, the issue of enforcement will primarily rest with NEMMCO.

The Commission therefore concurs with BP Energy Asia's comment that the issue of compliance monitoring and enforcement should be revisited if, and when, further obligations are imposed on Trader class participants.

The Commission considers the benefits of increasing competition and improving the potential for efficient price outcomes for the market by encouraging more foreign based businesses to participate in settlement residue auctions outweighs the compliance and enforcement concerns raised by NEMMCO in its submission. The Commission also considers its proposed amendment to the Rules will contribute to alleviating NEMMCO's concerns in this area.

---

<sup>19</sup> Taking action against a foreign based Trader would require steps to be taken to determine a court in Australia which is competent to determine the dispute, which country's law should be applied to resolve the dispute and whether a judicial decision made in one country may be recognised and enforced in other countries. Even if a court is competent to determine the dispute and a judgment is received, unless the foreign based Trader cooperates, the Commission considers enforcing the judgment overseas has the potential to be time intensive and costly.

### 3.3 Jurisdiction

NEMMCO raised in its submission that difficulty in determining which participating jurisdiction's legislation would apply to a foreign based Trader negates:

“the provisions by which eligibility for registration of Market Participants and Traders were constructed... so as to ensure that [legal] enforcement was possible in the most effective and efficient manner”<sup>20</sup>.

BP Energy Asia addressed NEMMCO's concerns in its supplementary submission with:

“Clearly, the Australian National Electricity Law would apply to all Trader participants (whether or not they are foreign-based).

In addition, for [BP Energy Asia] to participate in the Settlement Residue Auctions it is required to enter into an Auction Participation Agreement with NEMMCO, which is governed by the laws of Victoria.”<sup>21</sup>

The Commission concurs with BP Energy Asia's comment in its supplementary submission that the auction participation agreement is governed by the laws of Victoria. Clause 14.9 of the auction participation agreement<sup>22</sup> provides that each party to the agreement submits to the non-exclusive jurisdiction of courts exercising jurisdiction in Victoria in connection with the agreement and each settlement residue distribution agreement.

Furthermore, with the Commission's modifications to the Rule to require the local agent to be a party to the auction participation agreement and each settlement residue distribution agreement, the ability to enforce non-compliance with such agreements against the local agent ensures the efficiency and effectiveness of the current enforcement mechanisms is preserved.

### 3.4 Service of process

NEMMCO raised in its submission that:

“As [BP Energy Asia] states in its proposal, foreign-based counterparties such as itself can enter into over-the-counter derivative contracts in Australia. ...such entities are usually (if not always) required to appoint a “process agent” within the jurisdiction the relevant contract is governed by and that

---

<sup>20</sup> NEMMCO submission, dated 20 August 2007, p2.

<sup>21</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p2.

<sup>22</sup> Schedule 1 of NEMMCO's National Electricity Market Settlement Residue Auction Rules, 17 February 2006, p27.

the appointment of such process agents is also usually required to be irrevocable.”<sup>23</sup>

BP Energy Asia addressed NEMMCO’s concerns in its supplementary submission with:

“[BP Energy Asia] agrees that an irrevocable appointment of a process agent in Australia for foreign-based Traders would be beneficial for all involved.

To this end, [BP Energy Asia] irrevocably appoints BP Australia Pty Ltd as its process agent.”<sup>24</sup>

As stated earlier, the Commission considers the main risk associated with permitting foreign based Traders to participate in settlement residue auctions are the difficulties which may arise in enforcing the payment obligations of foreign based Traders under the Rules. In order to undertake any legal proceedings available to NEMMCO, the Australian Energy Regulator or any other Registered Participant, the Commission proposes to amend the Rules to require any foreign based Trader to appoint a local agent which is authorised to accept service of process in Australia on behalf of the foreign based Trader. However, the Commission notes that any legal action under the Rules can only be enforced against the Trader and not the local agent, as the agent is not a relevant participant for the purposes of enforcement under the NEL.

The Commission notes that a process agent may resolve the issue of service but the issue of enforcement would still remain. However, as noted above, NEMMCO, as the party to the auction participation agreements and also the settlement residue distribution agreements, will be able to take action against the local agent in accordance with those agreements.

### **3.5 Rule change proposal vs participant derogation**

NEMMCO raised in its submission that:

“the Commission should consider whether an application such as this is addressed more appropriately by way of derogation, rather than a Rule change.”<sup>25</sup>

BP Energy Asia made the following request in its supplementary submission:

“In consideration of NEMMCO’s concerns with a Rule change and in the interests of resolving a satisfactory solution to [BP Energy Asia’s] current inability to meet the Trader registration requirements, [BP Energy Asia] would respectfully request that...the [BP Energy Asia] submission to the

---

<sup>23</sup> NEMMCO submission, dated 20 August 2007, p2.

<sup>24</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p2.

<sup>25</sup> NEMMCO submission, dated 20 August 2007, p2.

AEMC be considered by way of a Participant Derogation rather than a Rule change”<sup>26</sup>.

The Commission has considered the possible benefits of increased competition in the settlement residue auction market as proposed by a Rule change, rather than a participant derogation. There are advantages to all energy users in broadening the number of eligible participants in settlement residue auctions, increasing the level of competition for such financial risk management instruments, and improving the potential for efficient price outcomes in the settlement residue auction market. This would also be consistent with one of the principles of NEMMCO’s Auction Rules, which is “to enhance competition and efficiency by promoting interstate trade in electricity”<sup>27</sup>.

As BP Energy Asia may be the first of a number of foreign based Traders that apply to participate in settlement residue auctions, it would not be efficient to process each application as they are received by way of a participant derogation. The Commission has therefore decided to address BP Energy Asia’s proposal as a Rule change rather than a participant derogation on the basis that it is appropriate to specify in the Rules the requirements for participation in settlement residue auctions that will apply to all foreign based corporations.

### **3.6 Implementation**

As noted earlier in this Rule determination, the Commission has included a clause that requires NEMMCO to amend the Auction Rules by 1 September 2008. This will enable foreign based Traders to participate in settlement residue auctions in September, should they meet the relevant requirements under Rule 2.5A.

In addition, the Commission has retained the savings and transitional arrangement from the draft Rule that ensures that any action taken by NEMMCO prior to the Rule commencing operation to amend the Auction Rules is taken to satisfy the equivalent action under the Rules.

The Commission also notes that the process to amend the Auction Rules should be sufficiently flexible to enable NEMMCO to address any restrictions on the agent that is appointed by a foreign based Trader as a party to the auction participation agreement and settlement residue distribution agreement, such as not being in concert with other auction participants, or being a Trader or Market Participant in their own right.

---

<sup>26</sup> BP Energy Asia supplementary submission, dated 12 September 2007, p2.

<sup>27</sup> NEMMCO Settlement Residue Auction Information Memorandum, dated 2 July 2007, p37.

### 3.7 The relevance of an Australian Financial Services Licence

BP Energy Asia raised in its second round submission:

“BP Australia Pty Ltd in its capacity as an agent for [BP Energy Asia Pte Ltd] as defined under the Draft Rule 2.5A(c)(2) is not licensed to deal derivatives under the Corporations Act.

As such, [BP Australia] could be regarded as dealing in derivatives and subsequently in breach of the Corporations Act if, as an agent for [BP Energy Asia], it is required to be a party to each SRD agreement between NEMMCO and the Trader (ie [BP Energy Asia]) as required under clause 3.18.1(e)(1) of the Draft Rule.”<sup>28</sup>

“If this is indeed the intention of the Draft Rule [ie that the Trader and its agent both be required to be classified as an “Auction Participant” as defined within the [Auction Participation Agreement]]... [BP Energy Asia] submits to the AEMC a proposed minor amendment to the Draft Rule that would allow [BP Australia] to act as agent for [BP Energy Asia] as defined under the Draft Rule 2.5A(c)(2) whilst maintaining the risk mitigation balance required by the AEMC”.<sup>29</sup>

The *Corporations Act 2001* (Commonwealth) requires persons carrying on a financial services business in Australia to hold an Australian Financial Services Licence (AFSL). Where settlement residue auctions would meet this criteria, as they deal in a financial product, the Traders who participate in these auctions will need to hold an AFSL.

The Commission considers that the robust financial services regulatory regime to be a necessary component in managing financial risk. Where this regime interacts with the Rules, namely settlement residue auctions and the participation of Traders, the Commission considers that this interaction provides an additional layer of regulatory certainty for all participants.

It is not the role of the Commission to determine who should hold an AFSL to participate in settlement residue auctions. That is a matter best dealt with under the Corporations Act and by the Australian Securities and Investments Commission. The Australian Financial Services Licensing regime applies equally to local and foreign based Traders who participate in settlement residue auctions. However, the Commission notes that the Australian Financial Services Licensing statutory framework has appropriate exemptions in place to address unique circumstances, where an AFSL is not required.

In its second round submission, BP Energy Asia has requested that the Rule be amended so that local agents are not required to hold an AFSL. The Commission confirms its policy decision in its draft Rule determination, which is that the purpose

---

<sup>28</sup> BP Energy Asia second round submission, dated 7 December 2007, p1.

<sup>29</sup> BP Energy Asia second round submission, dated 7 December 2007, p2.

of the local agent is to ensure the legal, financial and regulatory mechanisms available to dealing with a local Trader apply equally to a foreign based Trader, through its local agent, as far as practicable. For this reason, should a local agent be required to hold an AFSL, the Commission does not consider it appropriate to carve out this requirement from the Rule. That being said, the Commission considers the Rule to be made to be sufficiently flexible to accommodate any exemptions that the Australian Financial Services Licensing regime allows, without compromising the Commission's intention for including the local agent requirements on a foreign based Trader.

Having considered the issue raised by BP Energy Asia in its second round submission, the Commission reinforces that the intention of the Rule to be made is to ensure that there is a 'level playing field' for all Traders, either foreign or locally based ie the same requirements are to apply to all Traders when they participate in settlement residue auctions. The Commission considers it achieves this intention in the Rule to be made.

---

**See attached Rule to be made.**