



Futures Offset Arrangements (FOAs) - Rule Change Proposal – Section 108A Report

1 Purpose

The Commission is required under section 108A of the National Electricity Law (NEL) to publicly report on Rules not made within 12 months of public notification of request.

2 Background

On 10 January 2008, the Australian Energy Market Commission (Commission) received a joint Rule change proposal from Australian Power & Gas, Infratil Energy Australia and Momentum Energy (Proponents). This proposal essentially consisted of two parts:

- Part 1: Maximum credit limit (MCL) methodology: the Proponents proposed to modify the MCL calculation methodology in the National Electricity Rules (Rules). Rather than the MCL methodology using a backward looking price observation as a basis for predicting future pool prices, it would utilise Sydney Futures Exchange (SFE) electricity futures prices as the key inputs of the model, representing a forward looking view of future pool price outcomes.
- Part 2: Futures Offset Arrangements (FOAs): the Proponents proposed to define and accommodate FOAs within the Rules. An FOA would be a commitment entered into by an SFE Clearing Participant on behalf of a National Electricity Market (NEM) participant to redirect positive cash flows associated with the NEM participant's futures position to NEMMCO (to be held in a Security Deposit Arrangement (SDA)) to protect against the default of the NEM participant. In return, the NEM participant would only provide bank guarantee support to NEMMCO up to a level equivalent to the futures price at which the FOA was initiated and beyond which cash payment obligations from the SFE Clearing Participant to NEMMCO arise under the FOA.

On 14 February 2008, the Commission published a notice under section 95 of the NEL advising of its intention to commence the Rule change process and initial consultation on this Rule proposal. The Commission invited interested parties to provide submissions on the Rule proposal by 14 March 2008.

In accordance with section 99 of the NEL, the draft Rule determination were due on 20 May 2008.

The Commission has not made a Rule within 12 months from the time the notice under section 95 was published.

3 Reasons for the Rule change determination not being made within 12 months

The Commission has three times extended the period for making a draft Rule determination under section 107 of the NEL. The section 107 notices were issued on:

- 15 May 2008;
- 2 October 2008; and
- 11 December 2008.

3.1 Section 107 extension on 15 May 2008

On 15 May 2008, the Commission published a notice under section 107 of the NEL. This notice extended the period for publication of the draft Rule determination on FOAs to 2 October 2008.

The Commission considered that it was necessary to extend the publication period of the draft Rule determination due to complex issues associated with this Rule change proposal. The complex issues that required the extra time included the need for a detailed analysis of all the financial risks associated with the FOAs. The risk analysis included:

- the timing of payments;
- the early termination of FOAs;
- timing of registration of FOAs;
- payment in the event of default; and
- the obligations of SFE Clearing Participants under the Rules.

The Commission also required extra time to carry out the analysis on the proposed 'forward-looking' MCL calculations using SFE futures contracts against the existing 'backward-looking' historical spot price methodology.

3.2 Section 107 extension on 2 October 2008

On 30 September 2008, the Commission held a workshop with key stakeholders in relation to the Rule change proposal. Following this forum, the Commission considered that it was necessary to extend the publication period of the draft Rule determination to further review this Rule change proposal, including consideration of the following issues:

- enforceability of rights and obligations of relevant parties to the proposed FOAs;
- surety of payments under the proposed FOAs; and
- potential interactions between the NEL, the Rules, the Corporations Act and other relevant legislation.

The Commission considered that the issues were complex, and a time extension was necessary to undertake a comprehensive analysis to enable the Commission to have sufficient information to make an appropriate determination on this Rule change proposal.

Therefore, on 2 October 2008, the Commission published a notice under section 107 of the NEL. This notice further extended the period for publication of the draft Rule determination on FOAs to 11 December 2008.

3.3 Section 107 extension on 11 December 2008

On 11 December 2008, the Commission published a notice under section 107 of the NEL. This notice further extended the period for publication of the draft Rule determination on FOAs to 22 January 2009. The Commission considered the issues raised earlier in this draft Rule determination process were complex, and a time extension was necessary to further consider these issues.

4 Expected timing for the final Rule determination

The draft Determination for this Rule change proposal has now been published.

Based on the requirements in the NEL, the Commission considers it will make the final Rule determination for the *National Electricity Amendment (Futures Offset Arrangements (FOAs)) Rule 2008* by 16 April 2009.