



Australian Energy Market Commission

RULE DETERMINATION

National Electricity Amendment (Negative intra-regional settlements residue) Rule 2012

Rule Proponent

AEMO

Commissioners

John Pierce
Brian Spalding

22 March 2012

JOHN PIERCE

Chairman

For and on behalf of the Australian Energy Market Commission

**RULE
CHANGE**

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

Reference: ERC0139

Citation

Australian Energy Market Commission 2012, Negative intra-regional settlements residue, Rule Determination, AEMC, 22 March 2012, Sydney

About the AEMC

The Council of Australian Governments, through its Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. The AEMC has two principal functions. We make and amend the national electricity and gas rules, and we conduct independent reviews of the energy markets for the MCE.

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.

Summary

On 14 October 2011, the Australian Energy Market Operator (AEMO or Proponent) submitted a rule change request to the Australian Energy Market Commission (Commission) concerning the payment arrangements for negative intra-regional settlements residue.

AEMO has identified a risk associated with the current payment timing of this type of residue. It believes that alternative payment arrangements are required to reduce the risk of AEMO receiving late or short payments from Transmission Network Service Providers (TNSPs). This in turn, would reduce the risk of AEMO having to make short payments to market participants in the spot market settlements process.

AEMO is also seeking to align the payment of this residue with the existing payment procedures for negative inter-regional settlements residue to streamline the settlements process for AEMO and TNSPs.

Under the rule proposed by AEMO:

- AEMO would be able to determine the payment procedures for negative intra-regional settlements residue, including the payment time and interval in the settlements cycle;
- the definition of *settlements residue* in the National Electricity Rules (NER) would be amended to make explicit the term encompasses both types of settlements residue – that is, inter-regional and intra-regional settlements residue; and
- NER clause 11.1 would be deleted. This clause relates to historic payments of inter-regional settlements residue and is now redundant.

AEMO proposed that the rule change request be treated on an expedited basis by the Commission on the grounds that it is a non-controversial rule.

The rule change was formally initiated on 2 February 2012. At this time, the Commission gave notice of its intention to expedite the rule change request and asked for written requests not to do so – no requests were received. The Commission also asked for submissions to help inform its assessment of the rule change. TRUenergy and TransGrid provided submissions, which the Commission has considered in assessing the proposed rule against the National Electricity Objective (NEO).

The Commission has determined to make a final rule that will enable AEMO to decide the payment arrangements for negative intra-regional settlements residue and the interest charges associated with non-payment of those amounts. The final rule also deletes the redundant clause 11.1 and clarifies the definition of *settlements residue* in chapter 10 of the NER (the Glossary).

The final rule will commence on 5 April 2012. The rule largely adopts the rule proposed by AEMO, except that it includes a number of minor clarifications and transitional arrangements.

A transitional rule will apply the previous payment provisions until the new payment procedure has been determined by AEMO (in consultation with TNSPs). The transitional rule gives TNSPs the option to require AEMO to follow the formal rules consultation procedures when AEMO aligns the payment arrangements for both types of settlements residue for the first time.

Under this transitional rule, AEMO must notify each TNSP of how it plans to conduct consultation and the associated timing. If a TNSP wishes for the consultation to follow the rules consultation procedures, it must advise AEMO within one week of AEMO providing notice of its consultation plans.

The Commission considers the rule as made will enable AEMO to better manage the risks of TNSP short payment and, hence, reduce the risk of short payments to market participants. If market participants are short paid or if there is a perceived risk of short payment, this could result in higher costs for consumers in the long term.

In addition, ensuring there is one payment procedure for all TNSPs that applies to both types of settlements residue should simplify the TNSP settlement process. This is likely to result in marginally lower administrative costs for AEMO and TNSPs, which may result in marginal price benefits to consumers over the long term.

Contents

1	AEMO's rule change request	1
1.1	The rule change request	1
1.2	Rationale for the rule change request.....	1
1.3	Solution proposed in the rule change request.....	2
1.4	Relevant background.....	2
1.5	Commencement of the rule making process	3
2	Final rule determination.....	4
2.1	Commission's determination	4
2.2	Commission's considerations.....	4
2.3	Commission's power to make the rule	4
2.4	Rule making test.....	5
2.5	Compatibility of the rule as made with the proper performance of AEMO's declared functions.....	6
2.6	Other requirements under the NEL	6
3	Commission's reasons.....	7
3.1	Assessment of issues.....	7
3.2	Assessment of the rule.....	8
3.3	Civil penalties	10
4	Commission's assessment approach.....	12
5	Reducing the risks of short payments to market participants	13
5.1	Rule Proponent's view	13
5.2	Stakeholder views	13
5.3	Conclusion	13
6	Consistent with good regulatory practice	15
6.1	Rule Proponent's view.....	15
6.2	Stakeholder views	15
6.3	Conclusion	16
7	Costs and benefits of the rule for AEMO and TNSPs	20

7.1	Rule Proponent's view.....	20
7.2	Stakeholder views.....	20
7.3	Conclusion	21
Abbreviations.....		23
A	Summary of issues raised in submissions	24

1 AEMO's rule change request

1.1 The rule change request

On 14 October 2011, the Australian Energy Market Operator (AEMO or the Proponent) made a request to the Australian Energy Market Commission (Commission) to make a rule change regarding the payment arrangements for negative intra-regional settlements residue (rule change request).

The rule change request deals only with the payment of negative settlements residue – that is, it does not involve the payment arrangements for positive settlements residue. Where references to 'residues' are made in this determination, the Commission is referring to negative settlements residue.¹

1.2 Rationale for the rule change request

AEMO requested this rule change in order to make the NER consistent in its approach to the payment of both types of negative settlements residue (intra-regional and inter-regional). This involves changing the payment arrangements for intra-regional residues to match the current arrangements for inter-regional residues. This would enable AEMO to better manage the risks associated with TNSP payment of negative intra-regional settlements residue and to streamline the TNSP settlement process.²

TNSPs are required to pay negative intra-regional settlements residue on the market settlement date, which is the same day that AEMO pays all market participants for spot market settlements.³ The current rules do not permit AEMO to require TNSPs to pay negative intra-regional settlements residue earlier than the market settlement date. AEMO has requested this rule change as it believes that an earlier payment interval in the settlement cycle would enable AEMO to better manage the risks associated with these TNSP payments.

This payment approach is already in place for inter-regional settlements residue, where the TNSP makes the payment six days in advance of the market settlement date. This earlier payment is enabled by clause 3.6.5(a)(4) in the NER that permits AEMO to determine the payment time of day and the interval in the settlement cycle. AEMO is seeking to apply this clause to intra-regional residues and to implement one payment

¹ Negative settlements residue involves the appropriate TNSP paying AEMO the difference between what consumers owe to AEMO and what AEMO owes to market participants in a particular region, in order for the market to settle for a billing period. Further background is provided in the staff consultation paper on the Commission's website: www.aemc.gov.au.

² AEMO rule change request, Recovery of negative intra-regional settlements residue, October 2011, p.5.

³ The market settlement date is the date where the payment of final statements is required under clause 3.15.16 of the NER. It is also the date when AEMO pays market participants the money owed for a billing period. The market settlement date occurs 20 business days after the relevant billing period or two business days after the final statement is issued, whichever is later.

procedure for both residue types. By adopting a consistent payment procedure for both types of settlements residue, AEMO expects to streamline the TNSP settlement process.

In addition, AEMO is seeking to make a minor amendment to the NER definition of settlements residue for the avoidance of doubt that settlements residue includes residues from inter-regional and intra-regional settlements. This is to ensure there is no ambiguity around the rights and obligations of TNSPs and AEMO for the payment of residues.

Finally, AEMO is seeking to remove clause 11.1. This clause relates to historic payments of inter-regional settlements residue, which are no longer owed. This amendment is to improve the clarity of the NER by removing a redundant rule.

1.3 Solution proposed in the rule change request

The rule Proponent seeks to address the issues referred to in part 1.2 of this determination by proposing a rule that:

- Extends clauses 3.6.5(a)(4) and (a)(4A) of the NER to cover negative intra-regional settlements residue, enabling AEMO to determine when TNSPs must pay these amounts to AEMO.
- Amends the definition of *settlements residue* in the NER to make explicit that it includes intra-regional settlements residue and inter-regional settlements residue.
- Deletes NER clause 11.1 due to its redundancy.

For the purposes of this final determination, these three elements of the rule change request will be referred to as the 'Proposed rule'.

1.4 Relevant background

Relevant prior rule change arising from the Congestion Management Review

In 2009, the Commission made a rule that altered how negative inter-regional settlements residue was to be recovered. This rule change – the 'National Electricity Amendment (Negative Inter-regional Settlements Residue Amounts) Rule 2009' (the 2009 rule) – is relevant as it introduced clauses 3.6.5(a)(4) and (a)(4A), which are being modified by the rule as made. The introduction of these clauses in 2009 changed the recovery method for negative inter-regional settlements residue. It should be noted that the AEMO proposed rule is not seeking to modify the recovery method for intra-regional settlements residue.

Previously, negative inter-regional settlements residues were recovered from the Settlements Residue Auction. The 2009 rule changed this by requiring payment of these residues directly from the appropriate TNSP. It also enabled AEMO to determine the time, interval and method of payment following consultation with TNSPs. AEMO

adopted the payment procedure that is currently in place under which a TNSP pays negative inter-regional settlements residue through Austraclear by 4.30pm on the 14th business day after the billing period.

The rationale for the 2009 rule change differs to the rationale for the AEMO proposed rule.⁴ However, the fact that the Commission made the 2009 rule, enabling AEMO to determine the payment method and timing, is of relevance to the Commission's assessment for this final determination. Further discussion is contained in chapter 6 of this determination.

1.5 Commencement of the rule making process

On 2 February 2012, the Commission published a notice under section 95 of the National Electricity Law (NEL) advising of the commencement of the rule making process and consultation in respect of the rule change request. A consultation paper prepared by staff of the Commission identifying specific questions for consultation was also published with the rule change request.

The Commission determined that the rule change request was a request for a non-controversial rule because it only impacted the timing of a particular payment that occurs infrequently. It is therefore unlikely to have a significant effect on the national electricity market.⁵ Accordingly, the Commission intended to expedite the rule change request under section 96 of the NEL, subject to any written requests not to do so. The closing date for receipt of written requests was 16 February 2012. No request were received by the Commission and, hence, the rule change request was considered under an expedited process in accordance with section 96 of the NEL.

Submissions on the proposed rule and the staff consultation paper closed on 1 March 2012. The Commission received two submissions on the rule change request as part of its consultation. They are available on the Commission's website.⁶ A summary of the issues raised in submissions and the Commission's response to each issue is contained in Appendix A. One of the submissions raised issues of complexity that required consideration by the Commission. As such, the Commission extended the time for the making of a final determination and rule by one week in accordance with section 107 of the NEL.

⁴ The 2009 rule change sought to improve the ability of the inter-regional settlements residue units (associated with the Settlements Residue Auction) to act as an instrument to hedge financial risk associated with material network congestion. Further information is available in the relevant final determination, which is located on the Commission's website at: <http://www.aemc.gov.au/Electricity/Rule-changes/Completed/Arrangements-for-Managing-Risks-Associated-with-Transmission-Network-Congestion-Rule-17.html>.

⁵ Under section 96 of the NEL, a rule can be expedited if it is considered non-controversial. A non-controversial rule is 'a rule that is unlikely to have a significant effect on the national electricity market'.

⁶ A copy of the submissions are available under the 'completed' rule change section of the Commission's website: www.aemc.gov.au.

2 Final rule determination

2.1 Commission's determination

In accordance with section 102 of the NEL, the Commission has made this final rule determination in relation to the rule proposed by AEMO. In accordance with section 103 of the NEL the Commission has determined to make, with amendments, the rule proposed by the Proponent.⁷

The Commission's reasons for making this final rule determination are set out in part 3 of this determination.

The *National Electricity Amendment (Negative intra-regional settlements residue) Rule 2012 No2* (rule as made) is published with this final rule determination. The rule as made commences on 5 April 2012. The rule as made clarifies minor aspects of the proposed rule and includes transitional provisions. Its key features are described in part 3.2 of this determination.

2.2 Commission's considerations

In assessing the rule change request the Commission considered:

- the Commission's powers under the NEL to make the rule;
- the rule change request;
- submissions received during consultation; and
- the Commission's analysis as to the ways in which the Proposed rule will, or is likely to, contribute to the achievement of the National Electricity Objective (NEO).

2.3 Commission's power to make the rule

The Commission is satisfied that the rule as made falls within the subject matter about which the Commission may make rules. The rule as made falls within the matters set out in section 34 of the NEL as it relates to:

- the operation of the national electricity market; and
- the activities of persons (including Registered participants) participating in the national electricity market or involved in the operation of the national electricity system.

⁷ Under section 103(3) of the NEL the rule that is made in accordance with section 103(1) need not be the same as the draft of the proposed rule to which a notice under section 95 relates.

2.4 Rule making test

Under section 88(1) of the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the NEO. This is the decision making framework that the Commission must apply.

The NEO is set out in section 7 of the NEL as follows:

“The objective of this Law 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, safety, reliability and security of supply of electricity;
and
- (b) the reliability, safety and security of the national electricity system.”

The Commission is satisfied that the rule as made will, or is likely to, contribute to the NEO. The Commission considers that the relevant aspect of the NEO is promoting the efficient operation of electricity services for the long term interests of consumers of electricity with respect to price.⁸

The rule as made will enable AEMO to better manage the risks of TNSP short payment and, hence, reduce the risk of short payments to market participants. TNSPs are not required to provide credit support to AEMO. If the correct amount is not paid by the time of market settlement, AEMO must short pay all market participants owed money for that billing period. If market participants are short paid, or if there is a perceived risk of short payment, this could result in higher costs for consumers in the long term.

While negative intra-regional settlements residues have been historically infrequent, it is difficult to predict the frequency and magnitude of future residues.⁹ Regardless of their expected frequency and quantum, it is important there are clear arrangements in place should these residues occur in future. This is important because market participants could face significant costs if they are short paid, where a large settlements residue occurs and where a TNSP does not pay on time. Having a consistent approach to the settlement of both types of residues should make the payment rules clearer by bringing together the payment rules in one place.

In addition, ensuring there is one payment procedure that applies to both types of settlements residue and that applies to all TNSPs should simplify the settlements

⁸ Under section 88(2), for the purposes of section 88(1) the Commission may give such weight to any aspect of the NEO as it considers appropriate.

⁹ This type of residue arises due to the use of static marginal loss factors in the calculation of intra-regional transmission losses. They primarily occur where there is a high spot price in combination with high temperatures and/or high load. They can also arise due to metering issues and due to high marginal loss factors. AEMO considers that the 2011 rule change - the National Electricity Amendment (Application of Dual Marginal Loss Factors) Rule 2011 - that enabled dual marginal loss factors to apply at certain connection points will reduce the likelihood and magnitude of future negative intra-regional settlements residue.

process. This is likely to result in lower administrative costs for AEMO and TNSPs in the long term, which may result in minor price benefits to consumers over the long term.

Enabling TNSPs to require that consultation follows the rules consultation procedures¹⁰ for the change from current arrangements to the new procedure will help to avoid any unintended consequences for TNSPs that could be passed through as costs to consumers. The rules consultation procedure would provide TNSPs with a formal and well established process, if required, to highlight potential material impacts when aligning two disparate payment procedures.

Removing clause 11.1 and clarifying the definition for settlements residue will provide greater clarity to TNSPs and AEMO and will help to minimise the risk of misunderstanding the obligations and rights of TNSPs and AEMO.

2.5 Compatibility of the rule as made with the proper performance of AEMO's declared functions

Under section 91(8) of the NEL, the Commission may only make a rule that has effect with respect to an adoptive jurisdiction if it is satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator (AEMO)'s declared network functions. While recognising that AEMO is a TNSP in Victoria, the rule as made is compatible with AEMO's declared network functions because it will not interfere with or impede AEMO's performance of these functions.

2.6 Other requirements under the NEL

In applying the rule making test in section 88 of the NEL, the Commission has also considered whether there is a relevant Ministerial Council on Energy (MCE) Statement of Policy Principles as required under section 33 of the NEL. The Commission has determined that there are no relevant MCE Statements of Policy Principles for this rule change.

¹⁰ Requirements for rules consultation procedures are set out under rule 8.9 of the NER.

3 Commission's reasons

The Commission has analysed the rule change request and assessed the issues arising out of the request. For the reasons set out below, the Commission has determined that a rule be made.

The rule largely adopts the rule proposed by AEMO, except that it includes a number of minor clarifications and transitional arrangements. Our analysis of the rule proposed by the Proponent is set out below.

3.1 Assessment of issues

Currently, there are different rules applying to the payment of the two types of negative settlements residue. The payment of negative intra-regional settlements residue is treated like any other payment as part of the spot market settlement process and is subject to the timing in clause 3.15.16. This clause requires payment on the market settlement date, which is 20 business days after the billing period.¹¹

Under these arrangements there are approximately two and a half hours between TNSP payment and when AEMO must use the TNSP payment as part of its payment to market participants. TNSPs do not make regular payments in the market settlements process. This is because settlement residues are usually positive amounts, where AEMO is required to pay TNSPs. Given that negative settlements residues are less common, managing these payments is not core business for TNSPs. TNSPs may therefore not have the required internal systems in place to ensure the correct amount is paid on time. If the correct amount is not paid by the time of market settlement, AEMO must short pay all market participants that are owed money for that billing period.¹²

The payment of negative inter-regional settlements residue is treated differently to other settlement payment types and is subject to clause 3.6.5(a), where AEMO may determine the payment timing following consultation with TNSPs. Accordingly, AEMO has introduced a payment time for inter-regional settlements residue that is six days earlier than the market settlement date.

This has resulted in TNSPs being subject to two different payment times for a particular billing period, which depends on whether the negative settlements residue is intra-regional or inter-regional.

¹¹ Or two business days after the final statement has been issued, whichever is the latest. In practice this is 20 business days after the billing period because AEMO issues the final statement on the 18th business day after the billing period.

¹² Under the rules, TNSPs are not required to provide credit support to AEMO. The Commission notes that credit support is outside the scope of the AEMO rule change request.

AEMO has requested a rule change to align the payment arrangements for both types of settlements residues, although their proposed rule did not explicitly require this.¹³ This will help manage TNSP payment risk and streamline the TNSP settlement process. This would also enable AEMO to implement an earlier payment timing for intra-regional residues to better manage the risk of late or short TNSP payment.

Historically, the majority of large intra-regional residues have occurred in New South Wales, with TransGrid being the affected TNSP. While future residues are hard to predict, it is likely TransGrid and other TNSPs will owe residue payments to AEMO in the future. The Commission has consulted directly with TransGrid and with Grid Australia to ensure TNSP views were considered in informing its assessment of the rule change. This consultation has highlighted concerns from TransGrid that AEMO may unilaterally adopt a payment method under the rules that could impose material costs on TNSPs.

AEMO has indicated their intent to adopt the existing inter-regional settlements residue payment procedure for intra-regional residues. If this were the case, it is unlikely TNSPs will face new material costs. In addition, the amendments to existing payment procedures are likely to be relatively straightforward. The rule, however, does not require AEMO to adopt a specific payment procedure. As such, it is important that TNSPs are adequately consulted on payment procedures developed by AEMO.

AEMO is also seeking to modify the arrangements for interest on unrecovered negative intra-regional settlements residue by TNSPs. If TNSPs do not pay AEMO on time, costs can be incurred by AEMO and also by market participants who are short-paid as a result. AEMO considers the interest on unrecovered negative intra-regional settlements residue should be paid by a method and by a time to be determined by AEMO. This is currently the practice for interest associated with negative inter-regional settlements residue.

In addition to the issues outlined above, the definition of *settlements residue* in chapter 10 of the NER is currently not explicit that there are two types of residues included – intra-regional and inter-regional.

Finally, clause 11.1 is no longer required in the NER as it relates to payments that have already been recovered.

The Commission's assessment of the issues discussed above is that a rule change is required to improve the market settlements process.

3.2 Assessment of the rule

Extending clause 3.6.5(a)(4) and (a)(4A) to negative intra-regional settlements residue

The Commission has assessed AEMO's proposed rule and supports the approach to amend existing clause 3.6.5 to apply a consistent approach to the payment of

¹³ Parts 3.2 and 7.3 of this determination contain further discussion of this issue.

inter-regional and intra-regional settlements residues. This will enable AEMO to adopt one payment procedure for all TNSPs that applies to both types of residue. The rule as made clarifies minor aspects of the proposed rule to ensure it reflects the policy intent and current practice. It is for this reason that the rule as made contains some minor differences to the proposed rule – these differences are detailed later in this chapter.

Amending the definition of settlements residue

The Commission supports the proposal that the definition of *settlements residue* be amended in chapter 10 of the NER (the Glossary) to provide further clarity to stakeholders. This clarity may be helpful in the broader context of the rule change, where explicit references to inter-regional settlements residue in clauses 3.6.5(a)(4) and (a)(4A) have been removed. These clauses now refer only to *settlements residue*.

While the use of the term *settlements residue* in other NER clauses implies that it includes both intra-regional and inter-regional residues, the Commission considered that the definition in the Glossary could be expanded to further clarify that clauses 3.6.5(a)(4) and (a)(4A) apply to both types of residue.

Deletion of rule 11.1

The Commission supports the proposed deletion of rule 11.1 – 'Rules consequent on making of the National Electricity Amendment (Negative Inter-regional Settlements Residue Amounts) Rule 2009'. This rule stipulates how negative inter-regional settlements residues are to be recovered if they occurred in billing periods prior to the commencement of the 2009 rule. These residues have been recovered and rule 11.1 is therefore redundant.

Transitional rule

A transitional rule has been added that sets out the payment arrangements that are to apply until the new payment procedure has been determined by AEMO. This transitional rule states that payments of negative intra-regional settlements residue are subject to the old arrangements under clause 3.6.5 where a TNSP pays on the market settlement date.

The transitional rule also provides TNSPs the option to require that AEMO's consultation follows the rules consultation procedures¹⁴ when developing the first procedure under the rule as made. This is to ensure that any TNSP that is concerned about a new payment approach can have their issues heard and considered by AEMO under a formal and well established process.

The rules consultation procedures can only be required when AEMO first aligns the payment procedures for both types of residue under the rule as made. The Commission recognises that the time and costs associated with rules consultation procedures are unlikely to be justifiable for the purposes of AEMO making future

¹⁴ Provisions for the rules consultation procedures are set under rule 8.9 of the NER.

amendments to the payment timing. The consultation with TNSPs stipulated in clause 3.6.5(a) is considered appropriate for future amendments to payment timing.

Differences between the proposed rule and the rule as made

The Commission has made some minor amendments to the proposed rule to provide additional clarity and to ensure the rule as made meets the policy intent and reflects current practice. The rule as made differs from the proposed rule in the following ways:

- it clarifies that one payment procedure will apply to all TNSPs, consistent with the current practice for negative settlements residue;
- it clarifies that one payment procedure (i.e. payment method, interval and time) will apply to both intra-regional and inter-regional settlements residues, reflecting AEMO's intent to use one payment procedure for both types of residue to streamline the TNSP settlement process;
- the definition of *settlements residue* makes clear that there are only two types of settlements residue – inter-regional and intra-regional. The proposed rule suggested that there might be more than these two types of residue.
- it is explicit that AEMO may determine a payment time for settlements residue that is earlier than the date for payment under clause 3.15.16;
- it modifies clause 3.6.5(a)(4B) to ensure there is regulatory certainty concerning the 'appropriate TNSP' for negative inter-regional settlements residue;
- it reorders clause 4.6.5(a)(3A) to (4D) so that details on the 'importing region' directly follow the relevant subparagraph;
- it includes a consequential amendment to clause 3.15.1(a)(3) to make clear AEMO is responsible for managing both types of settlements residue; and
- it includes a transitional rule that makes clear which payment procedures apply prior to when the new AEMO procedures have been finalised. It also gives TNSPs the option to require rules consultation procedures to apply to the development of the new payment procedure.

As detailed in chapter 2 of this determination, the rule as made has been assessed against the NEO and the Commission is satisfied that it will, or is likely to, promote the efficient operation of electricity services for the long term interests of consumers of electricity with respect to price.

3.3 Civil penalties

The rule as made does not amend any rules that are currently classified as civil penalty provisions under the National Electricity (South Australia) Law or Regulations. The

Commission does not propose to recommend to the MCE that clause 3.6.5(a), as amended by the proposed rule, be classified as a civil penalty provision.

4 Commission's assessment approach

This chapter describes the analytical framework that the Commission has applied to assess the rule change request in accordance with the requirements set out in the NEL (and explained in chapter 2).

In assessing any rule change request against the NEL criteria, the first step is to consider the counterfactual arrangements against which the rule is being compared. In the present case, the counterfactual arrangements are that the payment of negative intra-regional settlements residue continues to occur on the market settlement date¹⁵, which differs to the payment timing for negative inter-regional settlements residue.

In assessing this rule change request, the Commission has considered the following issues:

- the impact of the rule on the efficiency of the broader market settlements process – in particular, any potential reduction in the risk of short payments to market participants as a result of short or late TNSP payment under the current rules;
- whether the rule is consistent with the principles of good regulatory practice; and
- the potential administrative/operational costs and benefits of the rule for AEMO and TNSPs.

The Commission has focussed on this set of issues because they were:

- raised by the Proponent in the rule change proposal;
- raised by stakeholders during consultation; and
- considered by the Commission to be of material significance as to whether or not the proposed rule would meet the rule making test.

¹⁵ As noted earlier, the market settlement date is the date for which spot market settlement payments are made by market participants and by AEMO (with the exception of negative inter-regional settlements residue). In practice, the market settlement date occurs 20 business days after the billing period.

5 Reducing the risks of short payments to market participants

The Commission has considered the potential impact of the proposed rule on the risk of short payments in market settlements including:

- whether the rule will reduce the risk of late or short payments made by TNSPs for negative intra-regional settlements residue; and
- as a consequence, whether the risk of short payments to market participants in the spot market settlements process is likely to be reduced.

5.1 Rule Proponent's view

The Proponent considers there is a risk to the spot market settlements process under the current arrangements if TNSPs do not pay the correct amount owing for negative intra-regional settlements residue on time. Where a late or short TNSP payment occurs, AEMO has approximately two and a half hours to contact the TNSP and attempt to rectify the situation before AEMO must short pay market participants.

AEMO considers that allowing it to determine alternative payment arrangements for negative intra-regional settlements residue would enable AEMO to more efficiently manage the risk of TNSP short payment. This, in turn, would reduce the risk of AEMO having to make short payments to market participants for a billing period.¹⁶

5.2 Stakeholder views

TRUenergy's submission to the consultation paper recognises that AEMO receives payments from TNSPs on the same day that AEMO is due to make payments to market participants. It considers that this process is inefficient and inconsistent with the NEO and, hence, supports the intent of this rule change.¹⁷

The submission from TransGrid did not comment on this issue.

5.3 Conclusion

The Commission recognises that the likelihood of the current payment arrangements for negative intra-regional settlements residue leading to a scenario where AEMO must short pay market participants depends on:

- the likelihood of a negative intra-regional settlements residue occurring; and

¹⁶ AEMO rule change request, Recovery of negative intra-regional settlements residue, October 2011, p.5.

¹⁷ TRUenergy submission, p.1.

- the likelihood that the TNSP responsible for payment would not pay the full amount owed to AEMO in time for when AEMO must pay market participants for a billing period.

Concerning the first point, the Commission notes that negative intra-regional settlements residues are difficult to predict. It is possible residues may be less likely to occur in the future than historically due to recent changes in the rules associated with static marginal loss factors.¹⁸ That said, the Commission considers it prudent to have appropriate rules in place to ensure there is a transparent and efficient payment approach for when these residues occur.

Concerning the second point, TNSPs could make a short or late payment for two reasons. The first is if they do not have access to sufficient funds to make the payment within the time required. The second, is if TNSPs do not have the appropriate operational procedures in place to ensure the correct amount is paid on time. The proposed rule change is not intended to address the first scenario where a TNSP may not have access to sufficient funds.

The risk AEMO is seeking to address with this rule change is the risk that TNSPs do not have the appropriate operational procedures in place to ensure the correct amount is paid on time. It is difficult for the Commission to assess the materiality of this risk due to a lack of information on TNSP internal processes. Based on the Commission's discussions with AEMO on payment issues that have arisen in the past, and given that no TNSP has refuted AEMO's claims that there is a risk of TNSP late or short payment, the Commission considers it appropriate for AEMO to implement new payment arrangements to manage this operational risk.

¹⁸ National Electricity Amendment (Application of Dual Marginal Loss Factors) Rule 2011.

6 Consistent with good regulatory practice

The Commission has considered whether the proposed rule is consistent with good regulatory practice, having regard to:

- whether it is appropriate for payment timing obligations to be contained in AEMO procedures;
- the extent to which the rule should prescribe conditions or principles for AEMO's implementation of the rule; and
- whether the rule provides greater clarity to market participants about their rights and obligations.

6.1 Rule Proponent's view

AEMO has stated that consistency in the treatment of both residue types under the NER is desirable. AEMO would use the consistent regulatory approach to adopt the same payment procedure for both types of residue in order to more efficiently manage TNSP payment risk and streamline the TNSP settlement process.¹⁹

In addition, AEMO considers that changes to the definition of settlements residue and removing rule 11.1 would provide greater certainty to market participants around their rights and obligations.²⁰

6.2 Stakeholder views

In its submission to the rule change consultation process, TransGrid stated that it would be appropriate from a good governance perspective to not enable AEMO to unilaterally change matters in the payment procedures. It stated that the requirement to consult with TNSPs is not sufficient and that agreement of affected TNSPs should be required, noting that agreement would not be unreasonably withheld.²¹ That is, the changes to clause 3.6.5 should be somewhat more prescriptive than the changes the Proponent put forward.

TRUenergy's submission to the rule change consultation process supported the less prescriptive approach put forward by AEMO in their proposed rule. The submission recognised that the proposed rule would enable AEMO to change the timing and process in any manner it chooses, but noted that TRUenergy considers this is not likely to occur in reality. TRUenergy stated that it understands AEMO plans to apply the

¹⁹ AEMO rule change request, Recovery of negative intra-regional settlements residue, October 2011, p. 5.

²⁰ Ibid.

²¹ TransGrid submission, 2012, p.1.

clause 3.6.5 to negative intra-regional settlements residue in the same way it currently does for inter-regional residues.²²

TransGrid has also requested in its submission that the notices for payment issued by AEMO to TNSPs should clearly indicate the amount payable, the due date of payment and the process of determining the claimed amount payable.²³ This would require a more prescriptive rule than the rule proposed by AEMO.

On the issues of amending the definition of settlements residue and deleting clause 11.1, TRUenergy's submission supported the Proponent's proposal as a means to improve the clarity of the NER.²⁴

6.3 Conclusion

As part of its role as the rule maker, the Commission must decide which provisions are appropriate for inclusion in the NER and which provisions should be outside of the NER in relevant procedure documents. The NER sets out the rights and obligations of participants with respect to the operation of the national electricity market (NEM). Procedure documents generally contain operational detail including procedural, technical and administrative requirements.

There is no clear rule as to the level of administrative detail that should be included in the NER. In determining whether it is good regulatory practice to contain timing obligations in AEMO procedures, the Commission considered the existing clause 3.6.5(a) for inter-regional settlements residue. The introduction of this clause essentially moved payment methodologies for inter-regional settlements residue from the NER to AEMO procedures. The rule as made would therefore adopt a consistent regulatory approach to this, with the payment timing to be contained in AEMO procedures.

The Commission considers that the proposed changes to clause 3.6.5(a) may reduce the regulatory certainty for TNSPs as to the timing of TNSP payments of negative intra-regional settlements residue. This is because AEMO procedures are not subject to the same statutory processes as rule changes. The Commission notes that TNSPs already face this degree of uncertainty for inter-regional residues. The impact of this uncertainty is considered to be marginal relative to the uncertainty that various market participants (including TNSPs) face in the operation of the NEM.

Importantly, the key obligations relating to who must pay the residues and how the residues are calculated remain unchanged under this rule – that is, these obligations are to be retained in the NER. Hence, it is just the timing of the payment that may change, subject to AEMO's consultation with TNSPs. The Commission considers that the rule strikes an appropriate balance between regulatory certainty and operational flexibility for AEMO to manage payment risks.

²² TRUenergy submission, 2012, pp. 1-2.

²³ TransGrid submission, 2012, p.2.

²⁴ TRUenergy submission, 2012, pp. 2-3.

The Commission recognises the concerns raised by TransGrid in their submission that the proposed rule enables AEMO to determine the payment arrangements for negative intra-regional settlements residue without the agreement of TNSPs. Further discussions with TransGrid identified that its primary concern was AEMO might unilaterally adopt payment procedures that are materially different to the existing procedures for negative inter-regional settlements residue and that may have significant cost impacts on TNSPs.

Subsequent discussions between the Commission and AEMO have confirmed that AEMO intends to adopt one payment procedure for both types of residue, which will apply to all TNSPs. AEMO intends for this procedure to mirror the current TNSP payment procedure for negative inter-regional settlements residue, where TNSPs pay residues 14 business days after the billing period.²⁵ As such, the Commission considers the risk of TransGrid's concerns materialising to be relatively low. Were this situation to arise, TNSPs could submit a rule change to alter AEMO's powers under clause 3.6.5.

For the settlements process to operate efficiently, there needs to be a clear payment procedure in place where all relevant stakeholders understand their rights and obligations. Were the rule to require that TNSPs agree the procedures prior to their implementation, this could potentially lead to an impasse if one or more TNSP objected to the proposed procedure for any reason. This would be an inefficient outcome where the potential benefits of requiring TNSP agreement are unlikely to outweigh the potential costs.

Requiring agreement to payment procedures is not consistent with the current NER approach for similar payments, including being inconsistent with the current approach for inter-regional residues.²⁶ It is important there is a decision maker in the process to avoid an impasse. The Commission considers that AEMO is the appropriate decision maker for these procedures.

The Commission recognises that the proposed rule does not require AEMO's consultation to follow the rules consultation procedures under rule 8.9 of the NER. AEMO has advised the Commission that it intends to follow a similar consultation process to that which was undertaken for the development of negative inter-regional settlements residue payment procedures. This involved AEMO publicly releasing the draft procedures on their website on 26 May 2010 for stakeholder comment. AEMO has

²⁵ This is subject to whether TNSPs raise any issues with the current procedures during consultation.

²⁶ Other examples include (but are not limited to) clause 2.11.2 where AEMO is to decide the payment amount and timing for participant fees; clause 3.12A.7 where AEMO must determine the shortfall payment amount; clause 3.3.8 where AEMO must determine the maximum credit limit and prudential margin; clause 3.3.4 where AEMO determines what is considered an acceptable credit rating for market participants; and clause 3.3.10 where AEMO determines the trading limit for a market participant.

stated that no stakeholder comments were received and it therefore adopted the draft procedures as final on 24 June 2010.²⁷

The rules consultation procedures involve following an established consultation structure and timeline.²⁸ The Commission recognises that there can be additional time and costs associated with rules consultation procedures and that this process may not be necessary to deal with changes to payment procedures that are relatively minor or straightforward.

As such, the Commission has determined that it is appropriate for TNSPs to have the option to require that consultation follow the rules consultation procedures when AEMO first introduces one set of procedures aligning the payment of both residue types. This would provide the option for TNSPs to work through any material issues with AEMO associated with current practices and the new arrangements, under an established and well understood consultation process.

The provision for rules consultation procedures is contained in a transitional rule.²⁹ Under this rule, AEMO must notify each TNSP of how it plans to conduct consultation and the associated timing. If a TNSP wishes for the consultation to follow the rules consultation procedures, it must advise AEMO within one week of AEMO providing notice of its consultation plans.

Once the payment arrangements have been aligned in a new procedure, clause 3.6.5(a) requires that AEMO consult with TNSPs on changes to the payment approach. However, the option for TNSPs to require that this consultation follow the rules consultation procedures is not provided. The consultation with TNSPs stipulated under clause 3.6.5(a) is considered a proportionate approach for the nature of future changes affecting the payment timing.

In the case of the proposed rule and the issue raised by TransGrid involving a requirement for certain information in notices for payment, the Commission considered it more appropriate for AEMO to work directly with TNSPs on this issue. This will enable AEMO to determine the most efficient, cost-effective way to perform its duties – rather than for the Commission to prescribe operational requirements that are ultimately business decisions for AEMO. Further, if the way in which AEMO implements its new payment procedures for negative intra-regional settlements residue is unsatisfactory for TNSPs, these businesses would have the opportunity to submit a rule change to the Commission to address these matters specifically.

The Commission considers that the changes to the definition of settlements residue and the deletion of clause 11.1 offer modest improvements in the certainty of market participants around their rights and obligations. Given that there were no submission objecting to these minor changes and TRUenergy's submission was in support of these

²⁷ AEMO's NEM Transmission Network Service Provider Payment Procedure webpage refers. This is located at: <http://www.aemo.com.au/electricityops/0508-0002.html>.

²⁸ The rules consultation procedures are set out in the NER under rule 8.9.

²⁹ Rule 11.45 in the rule as made.

changes, the Commission considers they should be adopted to provide minor benefits with negligible costs.

7 Costs and benefits of the rule for AEMO and TNSPs

The Commission's has considered the costs and benefits of the proposed rule for AEMO, TNSPs and other NEM participants, having regard to:

- the extent to which the rule will simplify the settlements process;
- the associated reduction in administrative costs for AEMO and/or TNSPs;
- whether there are costs for TNSPs or AEMO from changing the rule to require one payment procedure to apply to all TNSPs for both types of settlements residue;
- the potential increase in working capital costs for TNSPs if the payment of residues is required prior to the market settlement date; and
- whether the likely benefits of the rule outweigh the likely costs and promote greater operational efficiency in the NEM.

7.1 Rule Proponent's view

AEMO expects the proposed rule would benefit AEMO, TNSPs and market participants by reducing the TNSP payment risk and market settlement risk associated with negative intra-regional settlements residue. In addition, by introducing a consistent payment methodology and settlement cycle for both types of residues, AEMO expects the rule to help streamline the TNSP settlement process.³⁰

By amending the definition of settlements residue and deleting clause 11.1, AEMO expects the NER to be clearer to stakeholders by informing them of their rights and obligations, resulting in a minor benefit at no cost.³¹

AEMO anticipates minimal costs associated with the proposed rule, which are the costs of consulting with TNSPs, amending the existing payment procedure and amending the electricity market management system.³²

7.2 Stakeholder views

The staff consultation paper asked for submissions addressing the issue of potential working capital costs for TNSPs.

TRUenergy noted in their submission that it considers the proposed rule to be fair and reasonable, unless evidence is presented that demonstrates significant working capital

³⁰ AEMO rule change request, Recovery of negative intra-regional settlements residue, October 2011, p.5.

³¹ Ibid.

³² Ibid.

impacts on TNSPs that could impact consumer tariffs as a result of changing the payment timing under this rule.³³

In their submission, TransGrid stated that it was likely to be the most impacted of all TNSPs by changes to the payment arrangements for negative intra-regional settlements residue.³⁴ TransGrid did not provide an indication of the impacts on its working capital costs as a result of the proposed rule change.

TransGrid's submission supported aligning the payment procedures for both types of residues, but it also stated that the rule should require agreement by the affected TNSPs for changes to the payment procedures – rather than just requiring consultation.³⁵

In a subsequent meeting between TransGrid and staff of the Commission, TransGrid noted they were comfortable with AEMO extending the existing inter-regional settlements residue payment procedures to intra-regional residues. If AEMO were to make material changes to that payment approach, however, it is possible they would face material costs and it is for this reason that TransGrid considered that TNSP agreement to changes should be required.

7.3 Conclusion

The Commission considers this rule change is likely to pose minimal costs to market participants (including TNSPs) and those costs would likely be outweighed by the benefits of reduced short payment risks and simpler administrative processes.

The Commission considers the key cost of this rule change to TNSPs is the potential costs of accessing funds earlier than would be required under the existing arrangements. That is, the rule is not changing the quantum of payments that would be due, nor who is responsible for the payments. The only change is the timing of the payment.

Under the existing AEMO procedures for the payment of negative inter-regional settlements residue, AEMO banks the TNSP payments until the relevant settlement date and returns any interest accrued to the TNSP.³⁶ Provided that AEMO adopts the same payment procedures, which they have stated to the Commission they intend to do, the principle cost of the early payment to TNSPs would therefore be the difference between the interest earned on the early payment amount and any cost associated with funding the early payment.³⁷

³³ TRUenergy submission, 2012, p.1.

³⁴ TransGrid submission, 2012, p.1.

³⁵ Ibid.

³⁶ This detail is contained in the AEMO procedure document 'NEM Transmission Network Service Providers Payment Procedure' available on the AEMO website at: <http://www.aemo.com.au/electricityops/0508-0002.html>.

³⁷ The Commission understands that these costs may include the opportunity cost of the working capital over the period that the payment is brought forward, the daily interest charged on a loan to

The value of negative intra-regional settlements residue has historically peaked at around \$12.6 million for a particular billing period, with the majority of other material residues between \$1 million and \$5 million in a billing period.³⁸ While these amounts are material and the extra days' interest on loans of this size could present some costs to TNSPs, the TNSPs will be credited back some of this cost in the form of interest from AEMO's banking of the payment. The Commission considers the difference between the costs of accessing funds and the interest earned on the early payment is unlikely to be material enough to impact the operating expenditure of TNSPs.

The rule as made could offer marginal operational efficiencies (for AEMO and TNSPs) through ensuring there is one consistent payment procedure for both types of negative settlements residue and for all TNSPs. Both submissions supported aligning the payment approaches for both types of residue.

By enabling an earlier payment time for intra-regional residue than currently applies, it is likely AEMO can better manage the risk of late or short payments by TNSPs and avoid the costs associated with short-paying the market. These avoided costs include the cost of market participants not receiving the full amount owed to them for a billing period. They also include the administrative costs of AEMO having to adjust all payments for a billing period and later repay the remaining money owed to participants once the appropriate TNSP has paid.

The staff consultation paper noted that clause 3.6.5 is currently unclear concerning whether different payment procedures can apply to different TNSPs and asked for submissions raising a policy rationale for multiple payment procedures. In practice, AEMO has interpreted the rule by developing one procedure for all TNSPs. No submissions were received that requested the multiple payment procedure option. AEMO has also clarified with the Commission that it intends to continue using one payment procedure for all TNSPs. As such, the Commission decided to clarify the policy intent of the rule with a minor modification as outlined in the part 3.2 of this determination.

The Commission expects the rule as made is likely to promote administrative efficiency for TNSPs and AEMO in the settlements process and to help mitigate the risk of short payments to market participants.

fund the payment, and/or transaction costs of changing credit structures to obtain funding earlier than under the current requirements.

³⁸ AEMO rule change request, Recovery of negative intra-regional settlements residue, October 2011, p.3.

Abbreviations

AEMO	Australian Energy Market Operator
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	national electricity market
NEO	National Electricity Objective
NER	National Electricity Rules
TNSPs	Transmission Network Service Providers

A Summary of issues raised in submissions

Stakeholder	Issue	AEMC response
TRUenergy	Unless evidence is presented which demonstrates that changing the timing of these payments creates significant working capital impacts on TNSPs that could impact consumer tariffs, then TRUenergy consider this rule change to be fair and reasonable.	Information on working capital impacts has not been presented to the Commission by TNSPs. As such, the Commission has formed its own view of the materiality of these costs. Chapter 7 provides further detail.
TRUenergy	TRUenergy acknowledges that the rule change opens up the way for AEMO to change the timing and process that would apply to negative intraregional settlement residues in any manner AEMO chooses, it does not believe that this is likely to occur in reality.	The Commission shares this view, particularly given that AEMO has confirmed their intent to adopt a payment approach consistent with the current approach for negative inter-regional settlements residue (subject to any issues raised in consultation with TNSPs).
TransGrid	Any changes to the procedures should require the agreement of affected TNSPs (which should not be unreasonably withheld). The requirement to consult with TNSPs is not considered efficient in terms of good governance	The Commission considers that a decision maker is required to avoid the risk of an impasse. AEMO performs this role for other payment procedures in the NEM and the Commission considers it is appropriate and efficient for AEMO to continue to do so. In addition, TNSPs may submit a rule change if they are unsatisfied with how AEMO uses its power to determine the payment procedure. This is discussed in chapter 6 of the final determination.
TransGrid	The notices for payment claims under the proposed rule change to be sent out by AEMO to TNSPs should clearly indicate the amount payable, the due date of payment and the process for determining the claimed amount for the specific billing period to avoid ambiguity.	The Commission considers it more appropriate for AEMO to work directly with TNSPs to determine the most efficient, cost-effective way to perform its duties – rather than for the Commission to prescribe operational requirements that are ultimately business decisions for AEMO. This is discussed in chapter 6 of the final determination.