

Australian Energy Market Commission

DRAFT RULE DETERMINATION

National Electricity Amendment (Secondary trading of settlement residue distribution units)
Rule 2017

Rule Proponent

Westpac Banking Corporation

18 July 2017

**RULE
CHANGE**

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About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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Summary

The Australian Energy Market Commission (AEMC or Commission) has made a draft rule that amends the National Electricity Rules (NER) to enable the secondary trading of settlements residue distribution units through Australian Energy Market Operator's (AEMO) settlements residue auctions.

The draft rule, which is a more preferable rule, was made in relation to a rule change request submitted by Westpac Banking Corporation (Westpac) that was aimed at enabling, but not requiring AEMO to provide a platform for secondary trading. The Commission invites submissions on this draft determination including the draft rule by **29 August 2017**.

Background and rationale

Market participants who operate in more than one region of the National Electricity Market (NEM) may be exposed to price differences between regions. One way to manage this risk is to purchase units that provide the holder with a right to receive a portion of inter-regional settlements residue. These positive inter-regional settlements residues arise when there is a price separation between two inter-connected regions and electricity flows over an interconnector from the low priced region to the high priced region. The difference between the price paid in the importing region and the price received in the exporting region, multiplied by the amount of flow for each interconnector for a trading interval, results in surplus inter-regional settlements residue.

Currently, the NER neither promote nor prohibit the secondary trading of units in general. However, the NER do prevent AEMO from allocating auction proceeds to anyone but the relevant transmission network service provider (TNSP). Therefore, secondary trading through the auction process is effectively prohibited. The current secondary market, which generally only occurs through bilateral contracts, is not anonymous, is illiquid and in many cases, is hindered as a result of the negotiated nature of bilateral contracts. The ability of market participants to hedge and trade electricity across regions is limited by illiquidity of secondary markets.

The rule change request was informed by an informal consultation in 2016 amongst the members of the Settlement Residue Committee (SRC).¹ The AEMC published a consultation paper on the rule change request, and this draft determination is informed by stakeholder submissions on that consultation paper.

Features of the more preferable draft rule

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

¹ The SRC is a committee that is required to be established under clause 3.18.5 of the NER and is comprised of persons representing generators, market customers (retailers), TNSPs, government, traders, retail customers and AEMO.

The draft rule:

- enables auction participants to offer their previously purchased settlements residue distribution units (units) for sale at subsequent auctions facilitated by AEMO
- requires AEMO to distribute auction proceeds to either the relevant TNSP or auction participant, as the case may be
- requires AEMO to pay the relevant auction proceeds associated with the primary auction to the TNSP prior to paying out any auction proceeds to any secondary seller
- prohibits the auction rules from placing additional risks related to secondary trading on AEMO and TNSPs.

Benefits of the draft rule

Having regard to the issues raised in the rule change request, the Commission is satisfied that the draft rule will, or is likely to, better contribute to the achievement of the National Electricity Objective (NEO) by:

- allowing market participants to more efficiently manage their hedging risks across regions and therefore more efficiently deliver electricity services to consumers by increasing liquidity in the market for units
- in particular, increased liquidity in the market for units should reduce the risk faced by generators or retailers operating in more than one region. Where the risk faced by the retailer is reduced, consumers will benefit through reduced costs both in relation to the rate of return shareholders expect from the retail business but also, in relation to lower prices paid by consumers
- limiting the risk faced by TNSPs (and therefore their customers) to the risk they currently face in relation to units and requires auction participants to bear the risk associated with secondary trading.

If market participants are better able to optimise their portfolios on a liquid secondary market, that is likely to increase the efficiency of inter-regional trade and competition in retail markets. Consumers also benefit where risks are allocated to the parties that have the information, ability and incentives to best manage the counterparty risks. That is, TNSPs, and by extension their customers, are the appropriate party to bear the risk associated with primary units as they are the beneficiary of the auction proceeds of those primary units. By extension, the benefits of the secondary market are received by the secondary buyers and sellers (and more broadly by consumers) and therefore, these secondary buyers and sellers (and therefore consumers) should bear the risks that arise in the secondary market.

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1 Introduction and background

1.1 Settlements residue

Price separation between regions² of the NEM creates risks for parties that contract across those regions. This is because wholesale prices are set at the regional reference price.

Price separation occurs when interconnector capacity is not sufficient to equalise the spot price between a higher priced and a lower priced region in the NEM. If network conditions allow it, electricity flows from a lower priced region toward a higher priced one. In an unconstrained network, with unlimited capacity, this would result in perfectly coupled prices in all regions altered only by network losses. However, there is congestion in the NEM, and interconnectors do not always have enough capacity to allow for the equalisation of prices across regions.

The difference between the price paid in the importing region and the price received in the exporting region, multiplied by the amount of flow for each interconnector for a trading interval, results in surplus inter-regional settlements residue. More broadly, settlements residue is defined in the National Electricity Rules (NER) as "any surplus or deficit of funds retained by AEMO upon completion of *settlements* to all *Market Participants* in respect of a *trading interval*, being either *inter-regional settlements residue* or *intra-regional settlements residue*."³

Inter-regional settlements residue can be positive or negative. Negative inter-regional settlements residues arise when counter-price flows occur. Counter-price flows occur when electricity flows from the higher priced region to the lower priced one. There are several reasons why this can occur, including issues with, and errors in, the dispatch process, metering issues, bidding behaviour of scheduled generators, operation of particular transmission constraint equations, misalignment between five minute dispatch and 30 minute settlement periods, and non-compliance with dispatch targets.

The principles of allocation, distribution and recovery of the settlements residue are set out in clause 3.6.5 of the NER. These principles are different for regulated interconnectors and interconnectors that are operated by market network service providers. The rule change request and the Commission's analysis only relate to inter-regional settlements residues on regulated interconnectors (which include all interconnectors in the NEM with the exception of the interconnector between Tasmania and Victoria).

² The regions of the NEM include Queensland, New South Wales, Victoria, Tasmania and South Australia. For the purposes of regional pricing in the NEM, the Australian Capital Territory is part of the New South Wales Region.

³ See Chapter 10 of the NER.

1.2 Settlements residue auctions

The principles and requirements of settlements residue auctions are set out in rule 3.18 of the NER. However, the auction rules themselves are developed by AEMO in conjunction with and approved by the Settlement Residue Committee (SRC).⁴

1.2.1 Units and auctions

Current auction rules⁵ define units that refer to a particular directional interconnector⁶ (unit category) for a particular calendar quarter. There are six unit categories referring to both directions on interconnectors between Queensland and New South Wales, New South Wales and Victoria, and Victoria and South Australia.⁷ The maximum number of units in a category is determined and published by AEMO.⁸ It is based on the nominal capacity of the interconnector for each direction.⁹

The total number of units in a category that refer to a calendar quarter (also called the relevant quarter) represent the total value of settlements residue accrued in that calendar quarter in that unit category. For example, the 550 units available from New South Wales to Queensland for the second calendar quarter¹⁰ of 2017 represent the total value of inter-regional settlements residue accumulated in that direction, during that time period.

AEMO divides the maximum number of units by twelve, and holds twelve auctions once a quarter, ahead of the relevant quarter. One twelfth (1/12) of the available units is auctioned off at each auction.

⁴ See clause 3.18.3(d) of the NER. The SRC is a committee that is required to be established under 3.18.5 of the NER and is comprised of persons representing generators, market customers (retailers), TNSPs, traders, government, retail customers and AEMO.

⁵ See AEMO's website at <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Settlements-and-payments/Settlements/Settlements-Residue-Auction/Rules>

⁶ A directional interconnector refers to a conceptual grouping of all notional interconnectors (i.e. the regulated transmission assets comprising the regulated interconnectors) between two regional reference nodes, with one directional interconnector for each direction of flow.

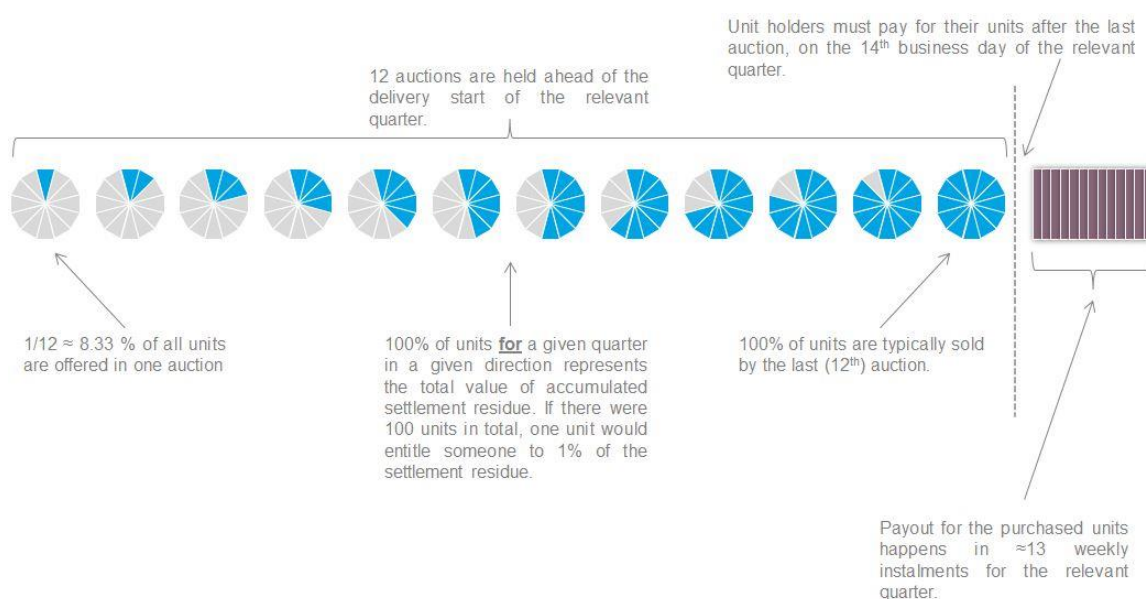
⁷ See section 4.2 of the Settlements Residue Auction Rules.

⁸ See AEMO's website: <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Settlements-and-payments/Settlements/Settlements-Residue-Auction/Number-of-units>

⁹ Throughout this draft determination, the term 'interconnector' is used to refer to the directional interconnector as described in clause 3.18.1(c) of the NER. In other words, if there is more than one regulated interconnector between two adjacent regions, they constitute a single interconnector.

¹⁰ The second calendar quarter refers to the time period between 1 April and 30 June.

Figure 1.1 Settlements residue auctions



Auction participants may submit bids for the price and quantity of units they are willing to purchase. The bid price must be greater than or equal to zero.

The auction has a common clearing price for each unit category and relevant quarter. The auction clearing price is set at the price of the lowest bid that was allocated a unit. All successful participants then pay this price for the units they acquire at the auction. If demand for units is less than the number of units offered at the auction, the clearing price is zero.

Auction participants may start participating in auctions three years (or 12 calendar quarters) ahead of the start of the relevant quarter, however, are only required to pay AEMO for the units they purchased by the 14th business day of the relevant quarter.¹¹ AEMO must then distribute the proceeds from the auctions to the relevant network service providers.¹²

1.2.2 Distribution of instalments

Settlements residue is calculated on a half-hourly basis, and aggregated on a weekly basis. After subtracting the auction expenses, AEMO pays the amounts proportional to the purchased units in weekly instalments. Payments are aligned with payments for the spot market (i.e. approximately five weeks after electricity flowed through the interconnector).

Generally, price differences between regions arise where there is insufficient capacity on the interconnector to equalise prices in adjacent regions. However small the price

¹¹ See section 10.3(c) of the Settlements Residue Auction Rules.

¹² See clause 3.18.4(a) of the NER. By way of example, for units relating to the Victoria to South Australia unit category, the relevant network service provider would be ElectraNet.

difference (and hence the weekly aggregated value) is between two adjacent regions, the payout for the corresponding units will not be less than \$10 per unit.¹³

As discussed in section 1.2.1, negative settlements residue can and does occur between regions. The risk of this occurring, and the corresponding reduction in payouts, used to sit with the unit holders. Where there was negative settlements residue in a trading interval, the deficit was recovered (deducted) from the weekly positive settlements residue payout. TNSPs were only responsible for any remaining negative settlements residue that was not recoverable from the unit payout.

Since 1 July 2010,¹⁴ however, auction participants do not bear the cost of negative settlement residues. It is instead recovered from the TNSP to which electricity was physically flowing (in the lower priced region) on a weekly basis.

1.2.3 Flow-on effects on TNSP's customers

The TNSPs' regulated revenue is set by the Australian Energy Regulator (AER) for a regulatory control period (typically a five-year period). As part of this process, TNSPs are also required to develop a pricing methodology for the AER's approval.¹⁵ The methodology sets out how much the TNSP will collect in relation to each group of prescribed transmission services in that year, to allow it to collect the relevant portion of its regulated revenue associated with that year.

TNSPs receive the auction proceeds, but are also financially responsible for negative settlements residue for the relevant quarters.

Of importance for this rule change request, the TNSP (as part of its annual pricing methodology) estimates the proceeds it expects to receive from the auction of the relevant units, the negative inter-regional settlement residue and the transmission use of system charges (TUOS charges) to be paid by the TNSPs' customers. Given the total revenue for the year is set, and assuming no changes in other prescribed transmission service components, if auction proceeds are forecast to increase, the TUOS charges would decrease, and vice versa.

It would be expected that the auction proceeds for an importing region which is forecast to have higher prices than the other interconnected, exporting region would be greater than for a region which is expected to have lower prices. Therefore the prices, all else being equal, paid by the TNSP's customers located in usually importing, higher price regions should be lower as a result of a lower TUOS component in the price which has been adjusted for increased auction proceeds.

On the other hand, negative settlements residue should also increase TUOS charges in lower priced regions, because the importing TNSP is responsible for these amounts. In these cases, it would be expected that this TNSP would receive a lower amount of auction proceeds (as it would be forecast that the region is generally the lower priced

¹³ See section 6.1 of the Auction Participation Agreement, which forms Schedule 1 to the Settlements Residue Auction Rules.

¹⁴ AEMC, National Electricity Amendment (Negative Inter-regional Settlements Residue Amounts) Rule 2009

¹⁵ See clause 6A.10.1 of the NER.

region) and would also be responsible for covering any negative settlements residue arising from the counter-price flows.

Regardless of the amount received from auction proceeds or paid to settle negative settlements residues, the TNSP's regulated revenue amount does not change. That is, the revenue that a TNSP may earn is determined in accordance with the revenue determination of the AER¹⁶ and is set for each regulatory year in the regulatory control period.¹⁷ Therefore, the TUOS charges collected from the TNSP's customers increase or decrease to ensure the TNSP collects the full amount of regulated revenue it is entitled to recover.

1.3 Secondary trading

Currently, the NER neither promote nor prohibit the secondary trading of units in general. However, the NER do prevent AEMO from distributing auction proceeds to anyone but the relevant TNSP. Therefore, secondary trading through the auction process is effectively prohibited.

Currently, secondary trading of units is only possible via AEMO's assignment process or bilateral or over-the-counter (OTC) contracts, and not through the settlements residue auction process. There is no organised market or trading platform for the purpose of facilitating secondary trading.

A person who wishes to participate in the settlements residue auction must enter into an auction participation agreement (APA) with AEMO, in a form satisfactory to AEMO.¹⁸ As part of the settlements residue auction rules, AEMO has developed a standard form APA, which states that assignment of units to other auction participants may only happen with AEMO's consent.¹⁹ The process and requirements for assignment are set out in a guide published by AEMO.²⁰

In addition to the assignment process prescribed by AEMO, parties are also able to trade units amongst themselves through bilateral, private contracts. In this case, the counterparty facing AEMO is not changed, i.e. the original auction participant who purchased units through the auction would be responsible for paying the clearing price from the auction in which the units were purchased. The original auction participant would also receive the pay out from the unit (i.e. the portion of settlements residue to which the unit relates). In such a case, the successful auction participant would enter into a contract with another legal or natural person that is not necessarily an auction participant. The seller of the units could agree to transfer future payments received during the weekly pay outs to the buyer in exchange for a payment for the units. AEMO would have no visibility over these types of contracts.

¹⁶ See clause 6A.3.1 of the NER.

¹⁷ Subject to any adjustment under rules 6A.7, 6A.8 or 6.15.

¹⁸ See clauses 3.18.1(a) and 3.18.3(a)(1) of the NER.

¹⁹ See section 14.4(b) of the Auction Participation Agreement, which forms Schedule 1 to the Settlements Residue Auction Rules.

²⁰ AEMO, Settlement Residue Distribution Agreement Assignment Guide, July 2016, p. 2.

2 Westpac's rule change request

On 16 December 2016, Westpac submitted a rule change request to the AEMC. The rule change request seeks to amend the NER to enable the secondary trading of settlements residue distribution units through AEMO's settlements residue auctions.

2.1 Rationale for the rule change request

In its rule change request, Westpac provided its rationale for the rule change. A number of key issues raised in the rule change request are summarised as follows:

- **lack of liquidity and anonymity:** Westpac estimated that the volume of units traded bilaterally is less than 1% of the volumes sold on AEMO auctions. This illiquidity reduces the efficiency of risk management, because positions may be difficult to optimise (i.e. reduce or increase the number of units in a portfolio if new information suggests price differentials will be lower or higher than expected) once units are purchased. Additionally, bilateral trade necessarily reveals the identity of the seller and the buyer to each other, while also revealing their hedging strategies. This is a risk that retailers and generators may not want to take.²¹
- **credit and settlement risk:** bilateral trading of units increases counterparty credit risk that secondary buyers and sellers need to manage.²²
- **ease of execution:** Westpac stated that secondary trading of units is hindered by the specific requirements around the assignment of units, which would be significantly simpler if such trading could occur through the existing auctions.²³
- **market preference for trade at auction:** due to internal procedures (such as the timing of planning and risk review processes aligned with settlements residue auctions) auction participants are reluctant to enter into bilateral agreements.²⁴
- **market inefficiency:** illiquidity and practical barriers to secondary trading may lead to the formulation of incorrect price signals.²⁵
- **auction participant default:** the risk of an auction participant defaulting before paying for the units it purchased could be reduced by the introduction of a liquid secondary market. This is because participants would be able to sell their unwanted units (if they are experiencing financial difficulties) more easily, hence reducing the risk of default and the resale of their units by AEMO at another auction, at a lower price.²⁶

²¹ Westpac, rule change request, 16 December, Appendix 1, 2016, p. 2

²² Ibid., p.2

²³ Ibid., p.2

²⁴ Ibid., p.3

²⁵ Ibid., p.3

²⁶ Ibid., p.3

The rule change request contained a proposed rule.²⁷

2.2 Solution proposed in the rule change request

This section provides a summary of Westpac's proposed solution to the issues it has raised in its rule change request.

2.2.1 Allowing, but not mandating, for the introduction of secondary trading via auctions

Westpac stated that allowing for the introduction of secondary trading of units via the same auction process already facilitated by AEMO would increase the liquidity of those units. This would, in turn, improve the efficiency of units as an inter-regional hedging tool by providing better opportunities for participants to manage portfolio risks.²⁸

The rule change request did not propose to mandate the introduction of a secondary trading mechanism. Rather, it was aimed at removing the implied restriction on secondary trading through the auctions that currently exists in the NER.²⁹ Prior to any secondary trading mechanism being implemented, the auction rules would have to be amended.³⁰ In amending the auction rules, AEMO must carry out consultation in accordance with the rules consultation procedures³¹ and seek approval from the settlement residue committee.³² Through this process, AEMO would be required to develop the more detailed aspects of any secondary trading mechanism through consultation with affected stakeholders.

2.2.2 The auction mechanism

In its rule change request, Westpac provided an explanation of what principles and mechanisms may follow from the proposed changes in the NER. However, Westpac reiterated that this was only one option as the final design or mechanism that would be implemented would be developed in the auction rules.

Facilitating transactions

In Westpac's rule change request, it provided an example of a mechanism that could be implemented to allow secondary trading through the current auction process.

²⁷ A copy of the rule change request and proposed rule can be found on the AEMC website: www.aemc.gov.au

²⁸ Westpac, rule change request, 16 December 2016, p.2

²⁹ That is, because under clause 3.18.4(a) of the NER, AEMO is required to distribute auction proceeds to the appropriate network service providers, this would be inconsistent with sellers of units receiving a portion of the auction proceeds for any sale of units.

³⁰ See clause 3.18.3(a) of the NER.

³¹ See clause 3.18.3(e) and rule 8.9 of the NER.

³² See clause 3.18.3(d) of the NER.

The proposed mechanism would allow auction participants to offer their previously purchased "primary units"³³ for sale on subsequent auctions. In theory, AEMO would cancel the units belonging to the "secondary seller", and then reissue those units to the "secondary buyer", independently.³⁴ Under this mechanism, primary and second units would be simultaneously offered for sale at the same auction.³⁵

Payments to TNSPs and auction participants

Generally, the auction proceeds paid to TNSPs would not be influenced by the price secondary units are traded at unless this also impacts on the clearing price for primary units. TNSPs are currently, and would continue to be, entitled to the amount defined by the unit price realised the first time it was auctioned.³⁶

The secondary trade is a transaction between the secondary seller and the secondary buyer, through the auction process facilitated by AEMO. Therefore, all profits or losses are borne by secondary sellers and would not impact on the primary unit auction proceeds paid to TNSPs, provided all auction participants honour their payment obligations and none of them default.

Currently, the NER only allow auction proceeds to be paid to TNSPs. Therefore, the rule change request sought an amendment to the NER that would allow for the payment of auction proceeds to either TNSPs (in the case of primary units) or secondary sellers (in the case of secondary units).³⁷

Managing default

Westpac stated in its rule change request that the proposed changes to the NER "clarifies that if AEMO incurs a shortfall after recovering costs from the proceeds of auctions, then recovery of the shortfall would align with the distribution of surpluses and recovery of negative settlement residue, i.e. it resides with the relevant Network Service Provider".³⁸ In other words, if an auction participant that previously purchased secondary units from a secondary seller defaults, that auction participant's units will be offered for sale at a subsequent auction. If the subsequent auction's clearing price is lower than the auction price at which the defaulting participant bought its units, the shortfall would be recovered from the relevant TNSP entitled to the primary auction proceeds.

³³ Throughout this draft determination, primary units refer to units that not previously sold at an auction, or were sold but were reauctoned. Secondary units refer to units that are not primary units and were sold previously at an auction.

³⁴ In practice, however, the two transactions cannot happen independently, unless the secondary seller defaulted and its units were offered for sale at a subsequent auction by AEMO. This makes AEMO a de-facto central clearing counterparty; an effective intermediary between secondary sellers and buyers of units.

³⁵ Westpac, rule change request, 16 December 2016, p. 3

³⁶ Ibid., p. 3

³⁷ Ibid., p. 3

³⁸ Ibid., p. 3

2.2.3 Stated costs, benefits and potential impacts

Westpac submitted a summary of costs, benefits and potential impacts associated with the rule change request. These are as follows:

- **costs to AEMO:** based on AEMO's estimation the costs for implementation would be between \$195,000 and \$285,000.
- **benefits to sellers and buyers:** anonymity, increased liquidity, simplified execution and reduced default, credit and settlement risk arising from secondary trading would benefit secondary sellers. If sellers are able to sell more easily, buyers could also receive the same benefits and be able to dynamically optimise the risks created by their changing portfolio.
- **potential impacts:** the value of units may not change significantly. The overall supply of units would not change, because only units that were previously bought could be offered for sale. As a result, prices should not be affected. If increased liquidity is strongly valued by participants that may cause an increase in prices. An incentive for bidding and purchasing units longer periods ahead may appear, as positions in units may be more easily managed.³⁹

2.3 The rule making process

On 11 April 2017, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.⁴⁰ A consultation paper identifying specific issues for consultation was also published. Submissions closed on 9 May 2017.

The Commission received ten submissions as part of the first round of consultation. The Commission considered all issues raised by stakeholders in submissions. Issues raised in submissions are discussed and responded to throughout this draft rule determination.

Issues that are not addressed in the body of this document are set out and addressed in Appendix A.

2.4 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination, including a draft rule, by 29 August 2017.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 25 July 2017.

Submissions and requests for a hearing should quote project number ERC0220 and may be lodged online at www.aemc.gov.au or by mail to:

Australian Energy Market Commission
PO Box A2449

³⁹ Ibid., p. 4

⁴⁰ This notice was published under section 95 of the National Electricity Law (NEL).

SYDNEY SOUTH NSW 1235

3 Draft rule determination

3.1 The Commission's draft rule determination

The Commission's draft rule determination is to make a more preferable rule. The draft rule enables, but does not mandate, the secondary trading of settlements residue distribution units through the existing settlements residue auctions facilitated by AEMO. The draft rule also prohibits the auction rules from placing additional risks related to secondary trading on AEMO and TNSPs.

The Commission's more detailed reasons for making this draft rule determination are set out in section 3.4.

This chapter outlines:

- the rule making test for changes to the NER
- the more preferable rule test
- the assessment framework for considering the rule change request, and
- the Commission's consideration of the more preferable draft rule against the national electricity objective.

Further information on the legal requirements for making this draft rule determination is set out in Appendix B.

3.2 Rule making test

3.2.1 Achieving the national electricity objective

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 national electricity objective (NEO).⁴¹ This is the decision making framework that the Commission must apply.

The NEO is:⁴²

“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 NEO captures the three dimensions of efficiency: productive (efficient operation), allocative (efficient use of) and dynamic efficiency (efficient investment).⁴³

⁴¹ Section 88 of the NEL.

⁴² Section 7 of the NEL.

⁴³ Productive efficiency means goods and services should be provided at the lowest possible cost to consumers; allocative efficiency means that the prices of goods and services should reflect the cost of providing them, and that only those products and services that consumers desire should be provided; dynamic efficiency means arrangements should promote investment and innovation in

3.2.2 Making a more preferable rule

Under section 91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NEO.

In this instance, this is because the draft rule, in comparison to the proposed rule, allocates risks to those parties (secondary sellers) that have the information, ability and incentives to best manage the relevant risks.

3.2.3 Making a differential rule

From 1 July 2016, the NER, as amended from time to time, apply in the Northern Territory, subject to derogations set out in Regulations made under the Northern Territory legislation adopting the National Electricity Law (NEL). Under these Regulations, only certain parts of the NER have been adopted in the Northern Territory.⁴⁴

The Commission has considered whether a differential rule is required for the Northern Territory and concluded that it is not required in this instance. This is because the provisions of the draft rule either:

- have no application in the Northern Territory because they relate to provisions of the NER that have no effect in the Northern Territory (i.e. chapter 3); or
- have no practical effect in the Northern Territory because although they relate to chapters of the NER that do apply in the Northern Territory (i.e. chapter 10), but the changes to that chapter relate only to provisions that have no application in the Northern Territory (i.e. they are definitions that are only used in provisions of chapter 3 that do not apply in the Northern Territory).

Therefore, as the draft rule relates to parts of the NER that currently do not apply in the Northern Territory, the Commission has not assessed the draft rule against additional elements required by the Northern Territory legislation.⁴⁵

3.3 Assessment framework

To determine whether the rule change request was likely to contribute to the achievement of the NEO, the Commission assessed the rule change request against an assessment framework. It should be noted that the design, operation and effectiveness of the units and auction process were examined by the Commission only to the extent necessary to inform its assessment of the appropriateness of allowing secondary trading.

the production of goods and services so that allocative and productive efficiency can be sustained over time, taking into account changes in technologies and the needs and preferences of consumers.

⁴⁴ For the version of the NER that applies in the Northern Territory, refer to: [http://www.aemc.gov.au/Energy-Rules/National-electricity-rules/National-Electricity-Rules-\(Northern-Territory\)](http://www.aemc.gov.au/Energy-Rules/National-electricity-rules/National-Electricity-Rules-(Northern-Territory)).

⁴⁵ National Electricity (Northern Territory) (National Uniform Legislation) Act 2015.

- **Design of units:** the Commission considered whether units provide a risk mitigation tool, and therefore, a more liquid secondary market is likely to provide market participants a greater ability to mitigate their price risk. The Commission also examined whether a secondary market in units facilitated through the AEMO auction process would be likely to limit the evolution or innovation of other, related financial products.
- **Efficient trade in electricity across interconnectors:** the Commission examined whether the ability of market participants to more easily access a secondary market for mechanisms or instruments that allow effective operation in more than one region is likely to lead to more efficient outcomes in respect to the management of inter-regional risks and therefore be in the long-term interest of consumers.
- **Value maximisation:** the Commission examined whether a more liquid secondary market is likely to result in increased value of the underlying instrument. The Commission also considered whether the added value of optionality to sell units is likely to outweigh the possibility of creating value for only non-customer facing entities in the market.
- **Efficient allocation of risk:** in assessing the rule change request the Commission found it necessary to assess the allocation of risk associated with the current auction process between the TNSP, unit holders and other market participants operating across multiple regions. This was done only to the extent of examining how this risk allocation may be impacted by the possibility of a secondary market through the AEMO auction process. The efficiency of this risk allocation, in relation to whether risks are being allocated to the party that has the information, ability and incentives to best manage the risks, was also assessed.
- **Competition:** the Commission examined impacts on retail competition that may arise as a result of the rule change request both in terms of access to units and other risk mitigation tools.
- **Costs and benefits:** the likely benefits of the proposed rule were balanced against additional costs that will arise as a result of the introduction of secondary trading. In this case, these costs included the costs of developing new auction rules, AEMO system and implementation costs and likely increased auction fees.

3.4 Summary of reasons

The draft rule, which is a more preferable rule, made by the Commission is attached to and published with this draft rule determination.

Importantly, the draft rule does not require secondary trading to be implemented. Instead, it removes the implied restriction on secondary trading and sets out certain requirements that would operate if secondary trading is implemented. If AEMO and the SRC decide to implement secondary trading, the auction rules must be amended accordingly, taking into account the requirements set out in the draft rule.

Other key features of the draft rule (which only operate if a decision to implement secondary trading is made) are:

- auction participants have the right to offer their previously purchased units for sale at subsequent auctions facilitated by AEMO
- AEMO is able to distribute the auction proceeds associated with the successful selling of units by auction participants
- the relevant TNSP is paid the primary auction proceeds before any payments are made to secondary sellers
- TNSPs and AEMO are not responsible for any shortfall in revenue associated with secondary trading. Auction participants bear the risk of counterparty default in relation to secondary sales.

Further detail on the draft rule can be found in Chapter 4.

Having regard to the issues raised in the rule change request and during consultation, the Commission is satisfied that the draft rule, which is a more preferable rule, will, or is likely to, better contribute to the achievement of the NEO by promoting the efficient operation and investment in electricity services for the long-term interests of consumers, for the following reasons:

- Although the units do not provide a firm hedge to unit holders, market participants use the units to provide risk mitigation where they operate in two interconnected regions.
- By allowing market participants to participate in a secondary market for units and improving the liquidity of the market, market participants will be able to more efficiently manage their risks and therefore more efficiently deliver electricity services to consumers. Units that can be traded more easily are also likely to bear greater value for market participants, resulting in higher auction proceeds. Where TNSPs are the recipient of the auction proceeds, increased auction proceeds, all else being equal, should reduce the TUOS charges to be collected from the TNSPs' customers.
- Risk allocation is considered efficient if it is being allocated to the party that has the information, ability and incentives to best manage the risks. Efficient allocation of risks in the NEM leads to lower costs for consumers as the adverse effects of default are better managed. TNSPs and by extension their customers, receive the benefit of the primary auction through the receipt of the auction proceeds. The TNSP bears the risk associated with default by a primary auction holder. Secondary buyers and sellers are the recipient of the benefits of secondary trading. The introduction of secondary trading changes the risk profile of this market as it separates the payment of auction proceeds from the right to receive inter-regional settlement residues associated with the unit. Therefore, as the recipient of the benefits of secondary trading are given the change in risks associated with a secondary market, it is appropriate that secondary buyers and sellers bear the risk associated with the secondary market, and not TNSPs and consumers.
- As a result of TNSPs receiving priority in relation to AEMO paying out auction proceeds, the TNSP, and by extension its customers, are at least in the same position as if secondary trading was not introduced. Further, where secondary

trading market participants are electricity retailers, their customers may benefit in terms of lower costs as a result of the retailer being able to better manage the risks faced from operating in inter-connected regions.

Further detail on these reasons can be found in Chapter 4.

4 Assessment of the draft rule

As a number of traditional synchronous generators are operating less or being decommissioned, access to local hedging contracts has also been decreasing. As a result, the importance of being able to underwrite hedging contracts across regions has been gradually increasing, especially for standalone retailers and generators. Cross-regional hedging contracts would benefit from being supported by instruments that help manage the basis risk associated with different spot price outcomes in adjacent regions. The Commission considers that the existing instruments that support the inter-regional trade of electricity can be improved by the introduction of auction based secondary trading, facilitated by AEMO.

This chapter summarises the key issues considered by the Commission in developing the draft rule. It outlines:

- how the current design of units and auctions provides a basis for the introduction of secondary trading
- how secondary trading is expected to incentivise efficient inter-regional trade, increase the value of units and lead to increased competition in regions
- how default risk is likely to change as a result of the introduction of auction based secondary trading and how this change will be efficiently managed by the parties that benefit most from secondary trading
- what direct and indirect costs and benefits are likely to occur as a result of the draft rule.

4.1 Design of units and auctions

Primary auctions and units were originally designed to allow market participants to manage the price risks associated with operating in more than one region of the NEM. Because of various reasons including interconnector constraints, the effectiveness of units as a risk mitigation tool that allows for inter-regional hedging may vary. Understanding the original rationale for the unit and auction design and how and why market participants participate in the auction, is an important consideration in determining the role of secondary trading and the benefits that may flow from it.

4.1.1 Westpac's view

Westpac in its rule change request did not address the question of whether primary auctions and units are effective risk mitigation tools for the purposes of inter-regional hedging.

4.1.2 Stakeholder views

Stakeholders generally were of the view that the current design of primary auctions remains fit for the purpose and no further inquiry is necessary into the issue.

Some stakeholders were concerned that consulting on matters that relate to the merits of the primary market would be out of scope of Westpac's original rule change request and the AEMC's ability to make a more preferable rule in relation to the primary market

would be out of scope.⁴⁶ Others noted that current arrangements in the primary market are effectively operating, and therefore no change should be made to the NER in relation to them.⁴⁷

ERM Power, however, was of the view that currently, the units as offered via the primary auction process were of little value for supporting interregional trading.⁴⁸

4.1.3 Assessment

As shown in section 4.2.3, the current design of inter-regional settlements residue auctions and inter-regional settlements residue distribution units do not allow for firm hedging across regions. However, their design has continuously been improved since their inception in 1999. The current design allows for multiple purposes, which include support for inter-regional hedging for market participants that have a physical position in the NEM, and speculative trade for traders that participate in auctions for the purposes of profit maximisation. The Commission understands that such variety of purposes also exist in other financial markets that underpin physical hedging in the NEM. Therefore, it is not a limit on the ability for the units to be used as a hedging tool where the market operates to meet more than one objective – in this case, hedging and speculation.

The Commission sought evidence on whether the current design of auctions allows market participants to use the units to hedge risks that arise from operating in interconnected regions. Stakeholder submissions confirmed that despite not providing firm hedges, units are indeed being used to support inter-regional hedging. Therefore, given the original unit and auction design were examined to determine if the units were being used for the intended purpose of providing an instrument for inter-regional hedging, the Commission is satisfied there is no basis for not considering the appropriateness of secondary trading on the basis of the design and mechanisms associated with the primary units.

4.2 Efficient inter-regional trade, value maximisation and effects on competition

Efficient inter-regional trade largely depends on whether price differences in regions can be managed by market participants. The efficiency of the primary market and the currently illiquid secondary market can be improved by introducing auction based secondary trading to the market, which in turn is likely to increase wholesale and retail competition in different regions. The ability to sell units adds value to the units in the form of optionality that already exists in liquid financial markets. Further, a liquid secondary market should reduce the overall risk faced by retailers as they will better be able to hedge their position as it changes over time. The reduction in risk faced by retailers is likely to flow through to consumers in the form of reduced costs both in

⁴⁶ AEMO submission, 5 May 2017, p. 2, Energy Network Australia submission, 9 May 2017, p. 2, Snowy Hydro submission, 9 May 2017, p. 2, South Australian Department of the Premier and Cabinet submission, 29 May 2017, p. 1, Westpac submission, 9 May 2017, p. 1

⁴⁷ AEMO submission, 5 May 2017, p. 1, Snowy Hydro submission, 9 May 2017, p. 2, AGL submission, 17 May 2017, p. 1

⁴⁸ ERM Power submission, 8 May 2017, p. 4

terms of the rate of return shareholders would expect from the business but also, in relation to lower prices paid by consumers. Section 4.2 summarises stakeholder submissions on the issue of supporting inter-regional trade, increasing competition, the value of units and the Commission's assessment of those issues.

4.2.1 Westpac's view

Westpac in its rule change request submitted that by allowing NEM participants to sell units at auctions, additional liquidity will allow participants to build their unit positions to their desired hedge levels. This could be done with the knowledge that they could reduce their positions if necessary in response to changing market conditions or portfolio requirements.⁴⁹ It added that net value is created by trading when an item has a different value to a buyer and a seller. In the case of units, participants might have different needs for those units based on the inter-regional mismatch between customer liabilities, generation and hedging contracts.⁵⁰ According to Westpac, allowing sellers to participate in the settlements residue auction directly enhances competition and efficiency in interstate trade of electricity.⁵¹ It noted that allowing sellers as well as buyers to determine the price of units at auctions will increase the amount of information captured within the unit prices.⁵²

4.2.2 Stakeholder views

Most stakeholders supported the introduction of secondary trading into AEMO facilitated auctions. This support was related to the possible market benefits a liquid secondary market could provide to the NEM.

AEMO was of the view that a liquid secondary market would be expected to provide participants with additional flexibility in building hedge positions, in the knowledge that they could confidently reduce a position in response to changed market conditions or portfolio requirements.⁵³ It also stated that the enablement of secondary trading would promote the NEO by enhancing allocative efficiency, as the reduction in transaction costs will enable units to be more freely traded to those participants that value them the most.⁵⁴

EnergyAustralia noted that at present the lack of liquidity in units reduces the accessibility and usefulness of settlements residue auctions as a hedging instrument. It submitted that the mathematical value per unit decreased after the scope of auctions was extended to three years (or 12 calendar quarters) in advance. It added that the required effort and timeframe over which analysis needs to be performed in order to participate in auctions reduces the worth of any given auction due to these limitations. EnergyAustralia was also of the view that as more units are reintroduced into the market the quantity of units increase the potential benefits in participating in any given

⁴⁹ Westpac rule change request, 16 December 2017, Appendix 1, p. 2

⁵⁰ Ibid., p. 4

⁵¹ Ibid., p. 4

⁵² Ibid., p. 4

⁵³ AEMO submission, 5 May 2017, p. 1

⁵⁴ Ibid., p. 2

auction.⁵⁵ EnergyAustralia considered that the introduction of secondary trading to AEMO facilitated auctions would enhance flexibility for participants using units in their portfolio. It added that the ability to sell units back into an auction is an improvement on the current mechanism, allowing participants to exit a position rather than waiting until settlement and making those units available for another buyer.⁵⁶

ERM Power submitted that allowing secondary trading would be a positive outcome as it would promote additional trading of units.⁵⁷ ERM Power further noted that with the NEM entering a period of greater uncertainty, effective and efficient interregional trading will be required to ensure stable risk management to ensure the lowest prices are available to consumers.⁵⁸

Epoch Capital was of the view that auction based secondary trading would positively increase liquidity while providing increased risk management options to portfolio managers.⁵⁹ Liquid Capital Australia considered that trading out of existing unit positions has been difficult. It added that improved liquidity arising from the rule change request would allow all participants to execute their strategies with anonymity and would also reduce the costs of auction participant default.⁶⁰

Westpac restated its view held in the rule change request that increased liquidity would give participants the ability to reduce a position size if needed at a fair market price. It was of the view that the ability to adjust positions sizes both up and down would allow participants to better achieve their desired inter-regional hedging strategy.⁶¹

AGL was of the view that auction based secondary trading would likely create market benefits by making trading easier, thereby increasing secondary market liquidity, allow participants to more readily optimise their portfolio and contribute to increased interstate trade of electricity and increase competition.⁶²

The South Australian Department of the Premier and Cabinet considered that facilitating secondary trading through the rule change request would improve and increase liquidity, which, in its view would produce reliable price signals essential to the development of OTC derivative markets and the ability for market participants to hedge their cash flow risks without owning generating portfolios. The Department noted that increasing liquidity provides greater opportunities for auction participants to manage their positions in the market. This allows participants to build their units positions to their desired hedge levels, with the knowledge that they could reduce their positions if necessary in response to changing market conditions or portfolio requirements. It further argued that a greater supply of units being offered for auction would reduce the price of risk so that the wholesale purchase of electricity costs by

55 Energy Australia submission, 9 May 2017, p. 1

56 Ibid., p. 2

57 ERM Power submission, 8 May 2017, p. 1

58 Ibid., p. 4

59 Epoch Capital submission, 17 May 2017, p. 1

60 Liquid Capital Australia submission, 19 May 2017, p. 1

61 Westpac submission, 9 May 2017, p. 4

62 AGL submission, 17 May 2017, p. 1

retailers would be lower, benefiting all consumers in the long run and contributing to the achievement of the NEO.⁶³

Snowy Hydro, however, submitted that existing mechanisms for secondary trading are sufficient and the introduction of auction based secondary trading would encourage speculation. Further, they indicated there was no rationale for auction proceeds to be distributed to someone else other than the TNSP.⁶⁴

4.2.3 Assessment

Efficient inter-regional hedging

Hedging within a region

If a retailer was to enter into a baseload swap contract with a generator located within the same region, they would agree on a quantity referring to the size of the load and a strike price. If the spot price is above the strike price, then the generator would pay the retailer the product of multiplying the agreed quantity by the price difference between the spot price and the strike price. In cases where the spot price was below the strike price, the retailer would pay the generator.

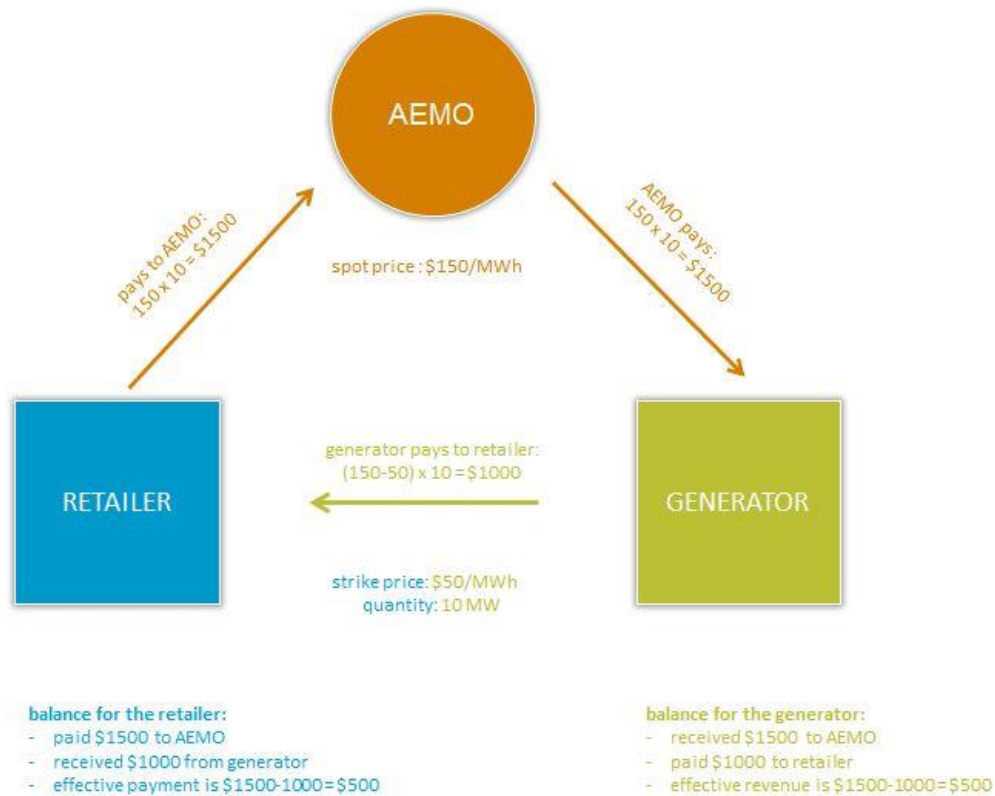
In the wholesale electricity market, the retailer will pay AEMO the spot price for the quantity of electricity consumed. AEMO will pay to the generator the spot price for the quantity of electricity produced.

The end result to the parties when they have entered into a swap contract and participated in the spot market, is the difference between the two cash-flows. Figure 4.1 reflects an example of the cash-flows between the parties for a baseload swap contract.

⁶³ South Australian Department of the Premier and Cabinet submission, 29 May 2017, p. 2

⁶⁴ Snowy Hydro submission, 9 May 2017, pp. 1-2

Figure 4.1 Hedging within a region



Hedge contracts within a region are generally directly between counterparties (bilateral trade) or through a futures exchange (the ASX for example).

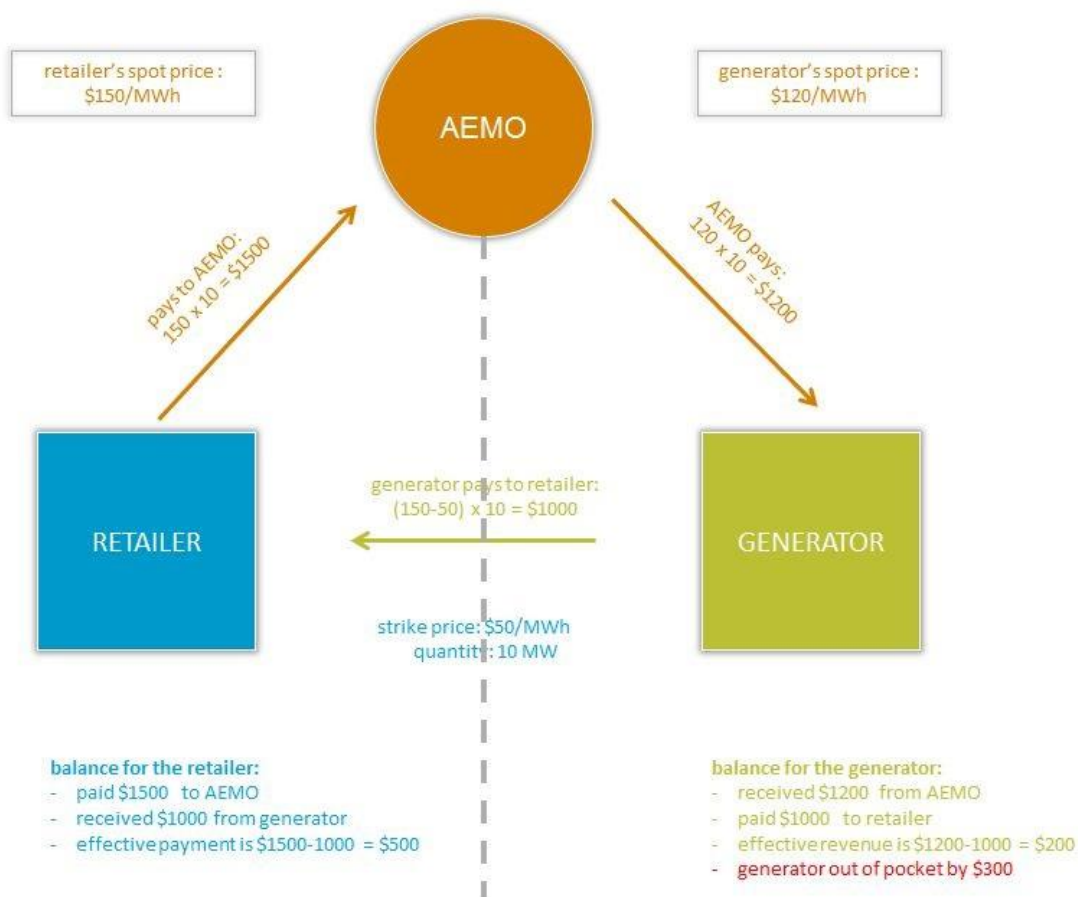
Hedging across regions

If a retailer would like to enter into a hedging contract with a generator located in another region, they would have to agree on which regions spot price would form the strike price for the contract. If the strike price for an inter-regional hedge is based on the spot price of the region where the retailer is located in, it creates "basis risk" for the generator.

Basis risk arises when there is a price separation between the generator's region and the retailer's region and the retailer's regional spot price is higher than the generator's. In these circumstances the generator would lose money on the contract. This is because the price difference between the strike price and the spot price in the retailer's region would be greater than the price difference between the strike price and the spot price in its own region. Contracting across regions may result in price differences not flowing through to the generator.

This basis risk also would hold for a retailer where the strike price used is in the generator's region rather than the retailer's.

Figure 4.2 Hedging across regions



In the example in figure 4.2, price separation between regions is responsible for the generator's loss. The \$30/MWh difference in the spot price, multiplied by the 10 MW load supplied across regions, is equal to a loss of \$300. If the interconnector between these two regions was never constrained and electricity flowed between the regions at the interconnector's nominal capacity, buying 10 units, equalling 10 MW would provide a firm hedge against this difference. This is a result of the settlements residue equalling the price difference (\$30/MWh) multiplied by the number of units purchased (10), which is \$300.

Hedge contracts across regions may exist in the form of bilateral trade, where at least one of the counterparties would need to manage the risk of price separation, typically by purchasing inter-regional settlements residue distribution units.

The ASX currently offers inter-regional swap contracts for a premium (spread). Hedging across regions on the ASX would involve buying a swap contract in one region and selling in the other. This can be problematic in regions where liquidity on the ASX has been traditionally quite low, such as in South Australia.

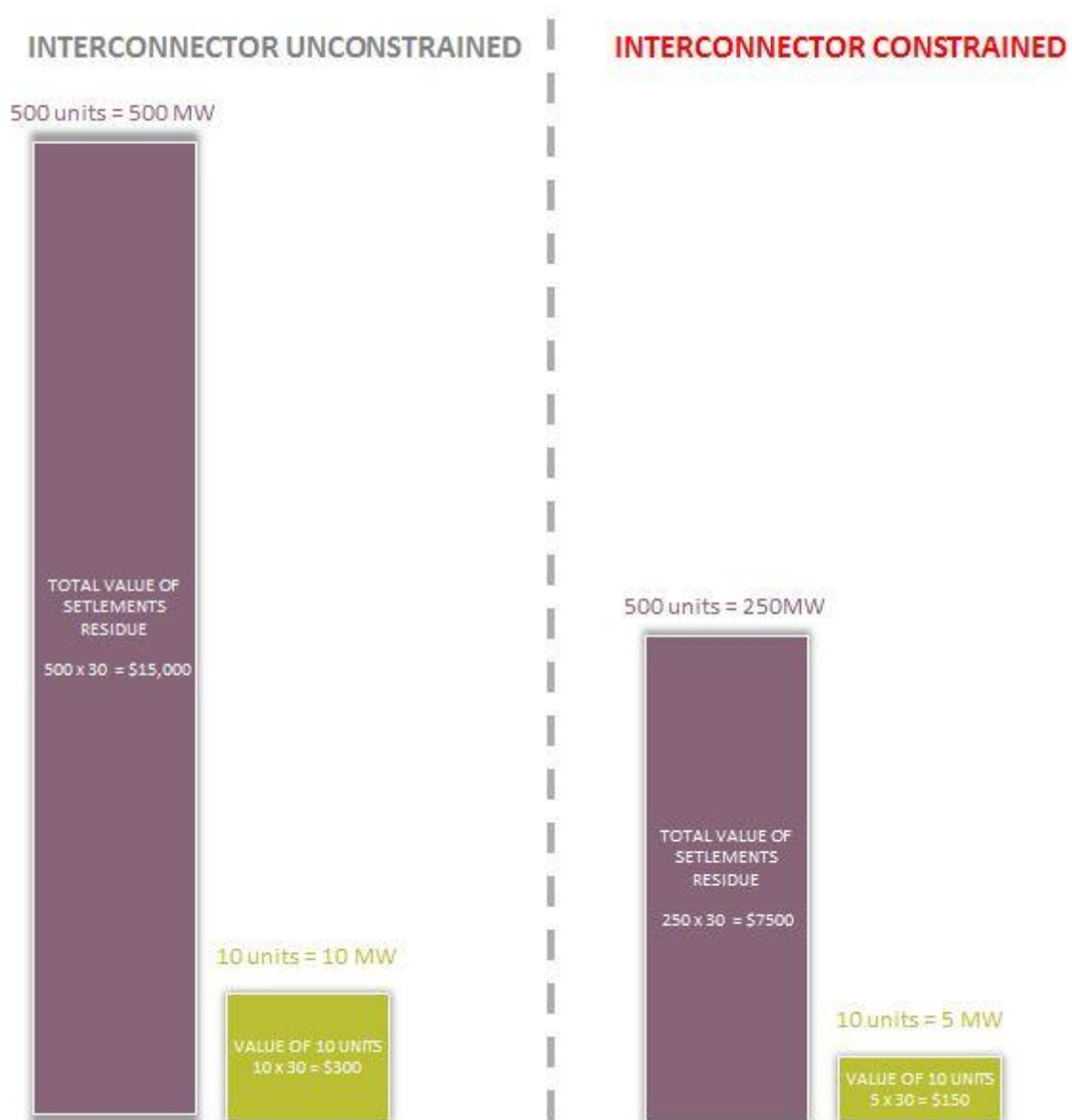
The firmness of hedging

As discussed in section 1.2.1, the number of units for each interconnector direction is based on the interconnector's nominal capacity. This means that one unit would be

equal to one MW capacity and would provide close to a perfect and firm hedge if the interconnector was always operating at its nominal capacity.

In practice, however, there are often binding constraints on the interconnectors. Figure 4.3 illustrates the difference between how units could serve as a hedging tool based on the previous example on both an unconstrained and a constrained interconnector with a nominal capacity of 500 MW with 500 available units. If there is a binding constraint on the interconnector, it can deliver less electricity from the lower priced region to the higher priced region. Therefore, the proportion of the value that 10 units represent is lower. In this example, it only represents 5 MW of capacity (i.e. the interconnector is only operating at 50 per cent of its nominal capacity).

Figure 4.3 Constrained versus unconstrained interconnector



The firmness of an inter-regional hedge (i.e. the coverage it can provide against price differences between regions) is best measured by the ratio between units and their capacity values in MW. On an unconstrained interconnector, this ratio is 100 per cent. When the interconnector is constrained this ratio will fall to less than 100 per cent and

when the interconnector is out of service this ratio would fall to zero. In the example above, the ratio is 50 per cent as 1 unit corresponds with only 0.5 MW capacity.

Often when price separation occurs between two regions, there is also a binding constraint on the interconnector. The result is that the constraint serves to decrease the firmness of the inter-regional hedge at the time it is needed the most.

Inter-regional hedging through the use of units may, therefore, be a high-risk exercise as the actual flow of electricity across the interconnector and price differences may be difficult to forecast. In the example above, a generator would need to have perfect foresight of the constraints and procure 20 units instead of ten, in order to protect its revenue against price differences across regions.

Forecasting future value

Auction participants must forecast the possible total value of inter-regional settlements residue that is to be accumulated in the future. The price participants are willing to pay at the auctions should reflect this value.

AEMO specifically indicates that there are several variables affecting inter-regional settlements residue and therefore, participating in auctions is financially speculative and carries a number of risks.⁶⁵ The higher risk nature of the units is due in part to the difficulty in forecasting the flow on an interconnector at any time, what the price separation may be at the time of the flow over the interconnector and whether, due to other market participant behaviour or circumstances, counter-price flows may occur.

Further, given the likelihood of the interconnector being constrained during a time when there is a price separation between regions, the units provide an imperfect hedge. However, the units do provide some insurance to participants that operate across two regions. Therefore, it would be expected that where units provide value as an inter-regional hedge, the unit price would reflect the insurance nature of the product.

The ratio between auction proceeds and payouts in the NEM over time is shown in Figure 4.4.

⁶⁵ <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Settlements-and-payments/Settlements/Settlements-Residue-Auction/Guide-to-settlements-residue-auction>

Figure 4.4 Unit proceeds versus payout

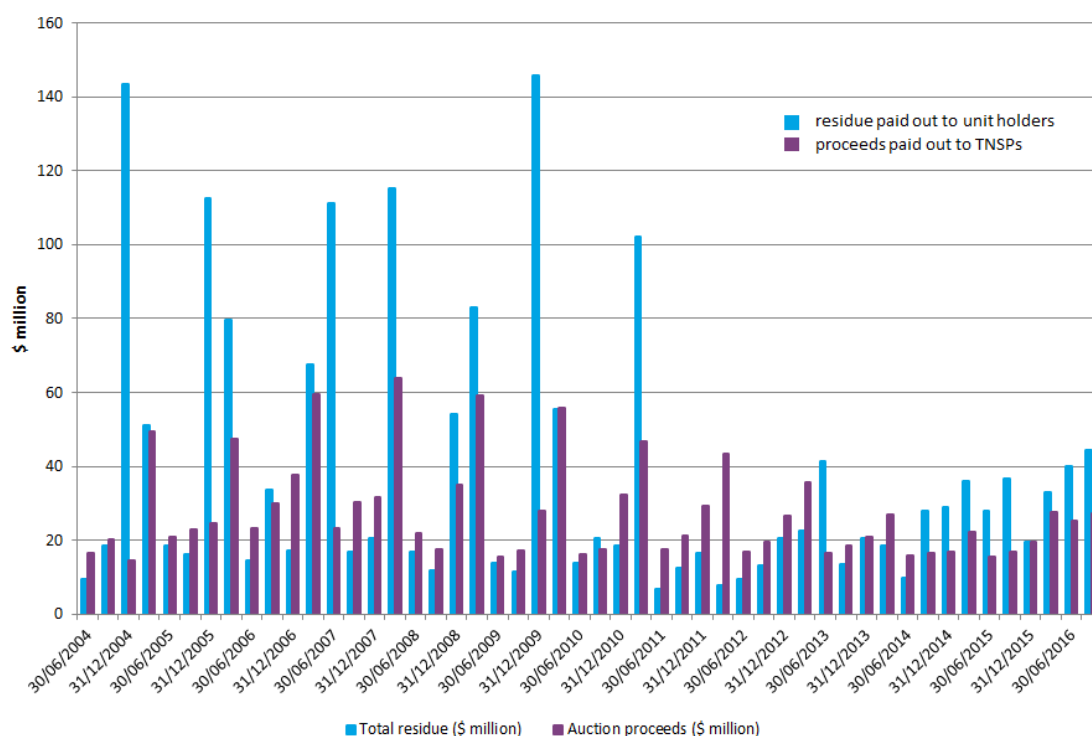


Figure 4.4 illustrates that no clear relationship or trend appears between payouts and auction proceeds over the past 12 years. Although, more recently for quarters relating to time periods from 2014 onwards, the inter-regional settlements residue paid out to unit holders exceeded auction proceeds. The Commission is of the view that this trend reflects market participants' expectation of a unit trading at discount to reflect the non-firm nature of the product.

Where the units are seen as a type of insurance against inter-regional price separation the price paid for units includes a premium over the payout amount. Based on the ratio between the actual auction proceeds and the unit payouts, this does not appear to be the case in most instances. However, in practice, this premium is often cancelled out by the unpredictability of payouts.

Given the high risk and volatility of these units, forecasting and the trading strategy of participants includes several elements and factors including the need to align forecasting and trading strategies with corporate risk and hedging strategies.

The inherent characteristics and calculation methodology of inter-regional settlements residue prevents units from being used as a perfect risk mitigation tool of inter-regional electricity trade. Because of this imperfection, the current design of units does not allow for firm hedging and making accurate forecasts about the future value of those units. However, the Commission is of the view that the purpose of units and their non-firm nature is well understood by those market participants that use them as risk mitigation tools. The Commission understands that units can and do support inter-regional trade, despite being non-firm and the payouts being hard to forecast.

The role of liquidity

Where secondary trading of units is provided through the AEMO auction process, the liquidity of units is likely to increase. Liquidity provides better opportunities for auction participants to manage their positions in the market. This is because as the delivery period approaches, participants become aware of previously unknown market conditions, including interconnector upgrades and maintenance.

In such cases, the retailer's position and underlying need for units change, and therefore, the number of required units also changes. There are numerous factors that impact on the number of units a market participant may need for the purpose of hedging. This may be due to changes in the portfolio being hedged, as well as issues impacting the firmness of the unit (i.e. factors impacting the interconnector). Increased liquidity of units allows parties to adjust their position regardless of the underlying reasoning for the re-adjustment. This provides confidence to market participants that they will be able to effectively manage their risks, which should result in more efficient operation of the market and benefits to consumers.

Changes to auction design

Although the draft rule does not impact on the original design of auctions and units, it creates an increased opportunity for optimising the number of units that are required for a certain volume of inter-regional hedging. This is because as the start of the relevant quarter draws close, auction participants are better able to forecast the expected physical conditions in the NEM that are likely to influence interconnector flows, price differences between regions and, therefore, the payout associated with the units they hold.

The draft rule therefore allows for the introduction of secondary trading via the existing auctions facilitated by AEMO, but does not mandate the implementation of secondary trading in the auction. It does so, by introducing clauses to the NER that allow AEMO to pay out auction proceeds to auction participants,⁶⁶ rather than to TNSPs only.⁶⁷

Currently an auction participant receives the right to a portion of the net surplus inter-regional settlements residue and has an obligation to pay for such a right when it successfully bids for a unit. In order to allow secondary trading, auction participants must be able to cede their previously acquired right in exchange for an expected auction proceed payment from one or more secondary buyers. In an auction based secondary trading platform facilitated by AEMO, this may only occur if the holder of a unit is allowed to offer its unit back to the auction for cancellation and sale.⁶⁸

Under the draft rule, a secondary seller, through its Settlements Residue Distribution (SRD) agreement remains contractually obligated to pay to AEMO the auction proceeds associated with the unit it has purchased (i.e. the clearing price of the unit). However, it will no longer have the right to a portion of the inter-regional settlements residue

⁶⁶ The NER uses the term 'eligible person' to describe those persons who participate in auctions under rule 3.18 of the NER.

⁶⁷ See clause 3.18.4(a5) of the draft rule.

⁶⁸ See clause 3.18.1(b)(2) of the draft rule.

payout, as this right is cancelled.⁶⁹ The secondary seller agrees to this cancellation in exchange for the auction proceeds representing the new unit price under which the secondary seller offered its units for cancellation. Despite ceding its right to the settlements residue payout through cancellation of the unit, the auction participant still retains its obligation to pay the purchase price for the unit. The draft rule therefore provides that the underlying settlements residue distribution agreement (SRD agreement) between the auction participant and AEMO is not terminated following cancellation of a unit,⁷⁰ such that the contractual obligation to pay AEMO under the SRD agreement remains in place.

The draft rule does not define the conditions upon which an offer for cancellation and sale must be accepted by AEMO; instead it provides for the process and mechanism for secondary trading to be done in accordance with auction rules.⁷¹ The Commission considers it is appropriate that the detailed design of the secondary trading mechanism is set out in revised auction rules rather than the NER. This ensures consistency with the current regulatory framework for the auction and provides flexibility to AEMO to adjust the auction rules as market conditions change.

By allowing market participants to participate in a secondary market for units and improving the liquidity of the market for units, market participants will be able to more efficiently manage their risks and therefore more efficiently deliver electricity services to consumers. Units that can be traded more easily are also likely to provide greater value for market participants, resulting in higher auction proceeds that may lead to TNSPs having to collect less TUOS charges from its customers. Therefore, the Commission is of the view that the draft rule, which is a more preferable rule, is likely to better contribute to the achievement of the NEO.

4.3 Efficient allocation of risk

The risk of counterparty default in the existing auction process is borne by the TNSPs (and consequently, its customers), but the current secondary market has a different allocation of risks, whereby participants that decide to trade units are responsible for bearing any additional default or credit risk.⁷² Depending on the ultimate design of the auction for secondary trading that would be implemented through revised auction rules, secondary trading could increase the risks faced by TNSPs and therefore, its customers.

4.3.1 Westpac's view

Westpac in its rule change request stated that current methods of secondary trading involve a certain level of counterparty default risk. Credit or settlement risk against counterparties other than AEMO could be eliminated with the introduction of auction based secondary trading.⁷³ Westpac noted that auction participant default creates the

⁶⁹ See clause 3.18.1(b)(2) of the draft rule.

⁷⁰ See clause 3.18.3A(c) of the draft rule.

⁷¹ See clause 3.18.1(b)(2) of the draft rule.

⁷² See section 1.3 for a description of the current secondary market.

⁷³ Westpac rule change request, 16 December 2017, Appendix 1, p. 2

risk of losses occurring to TNSPs (and therefore its customers) if the market value of units decreases in the period between when the defaulting auction participant purchased the units and when the units are finally offered for resale. It was of the view that allowing auction participants the ability to get out of unit trades earlier, participants would be more able to actively decrease their risk when desired, lowering the exposure under a default event.⁷⁴

Westpac proposed that if there was a shortfall while recovering costs from auction proceeds, the relevant TNSP would be required to cover that shortfall. This would mean that TNSPs (and by extension, their customers) would bear the counterparty default risk of secondary trading in the same way they do in relation to the primary market.⁷⁵

4.3.2 Stakeholder views

Stakeholders had differing views on the issue of efficient allocation of risk, stemming from the rule change request.

AEMO was of the view that it is highly unlikely that an auction participant defaulting on a secondary unit could lead to payments from the TNSP to the secondary seller arising. In AEMO's view, the following events would need to materialise in order for such an outcome to occur:

- a large number of units are offered for re-sale in a single auction and purchased by a single buyer
- despite the large supply of units, the auction clearing price is very high on that auction
- the buyer of the units defaults and is suspended by AEMO
- AEMO re-auctions the units and the clearing price is lower than that received by the seller, creating a shortfall in proceeds to pay the secondary seller
- the losses incurred by those units are greater than all proceeds received by the affected TNSPs from other units sold in that auction.

Therefore, in this scenario, the relevant TNSP would be required to make a payment to AEMO to make up the difference payable to secondary sellers.

Westpac stated that secondary trading does not materially increase the default risk faced by TNSPs, and auction participants do not have better information, ability and incentives to manage the risk of default in comparison to TNSPs.⁷⁶ Furthermore, it added that if default risk was to be managed, its exact details would be determined in public consultation by AEMO.⁷⁷ Westpac was also of the view that applying different risk management obligations (i.e. if collateral or up-front payment were required) to

74 Ibid., p. 3

75 Westpac rule change request, 16 December 2017, p. 3

76 Westpac submission, 9 May 2017, pp. 4-5

77 Ibid., p. 4

primary and secondary trading would not be beneficial, because it would create two separate financial products, the latter being less preferable to hold than the former.⁷⁸

ERM Power suggested that counterparty default risk would be best managed by implementing an initial and variation margin regime for both sellers and buyers of units, similar to the initial and variation margin arrangements utilised for trading of electricity futures on an exchange. It was also of the view that the SRC is best placed to provide both guidance and assistance to AEMO in developing the process, methodologies and procedures to be adopted with regard to those default risk mitigation options.⁷⁹

AGL was of the view that consideration should be given to the appropriateness or otherwise of prudential charges for unit holders, if the proposed rule change were to be implemented, in order to reflect the credit risk and embedded optionality of the units.⁸⁰

Snowy Hydro submitted that increased speculation resulting from secondary trading would heighten the risk of defaults in the market. It added that this higher risk of default would increase the risk that TNSPs would receive less from auction proceeds.⁸¹

Energy Networks Australia was of the view that if a secondary trading mechanism for settlement residue distribution units was allowed, some form of collateralisation or a default risk fund could be considered as a prudential option. It added that auction participants have better information, ability and incentives to manage the risk of default than TNSPs.⁸² Energy Networks Australia was also concerned that if secondary trading was to be enabled on auctions facilitated by AEMO, ultimately consumers could be responsible for a counterparty default risk in what can reasonably be perceived as a speculative market. It added that, should AEMO facilitate this arrangement, this counterparty risk appears to allocate the residual risk on a party, poorly placed to manage such commercial risks.⁸³

4.3.3 Analysis

Current default procedure

As a result of the current auction design not requiring collateralisation of risks from auction participants, any risk of counterparty default is borne by TNSPs. Figure 4.5 illustrates the risk stemming from an auction participant default under the current auction rules.

78 Ibid., pp. 4-5

79 ERM Power submission, 8 May 2017, p. 4

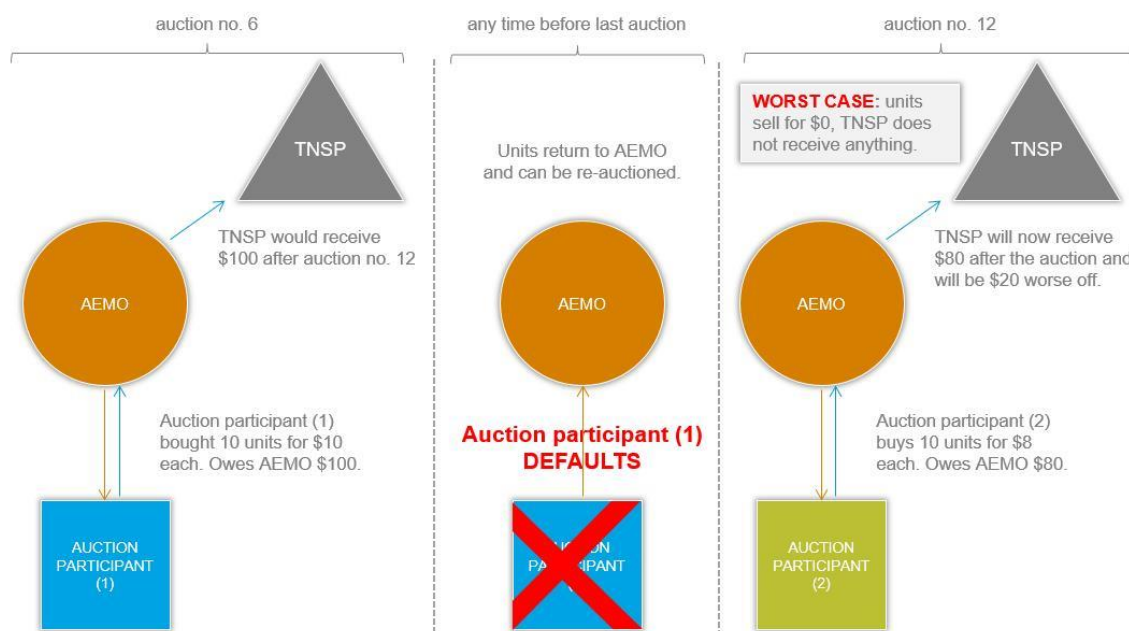
80 AGL submission, 17 May 2017, p. 2

81 Snowy Hydro submission, 9 May 2017, pp. 1-2

82 Energy Network Australia submission, 9 May 2017, p. 4

83 Ibid., p. 5

Figure 4.5 Current default procedure



If a participant defaults, its units are cancelled by AEMO and are then re-auctioned at another auction, if there is time. If the price at the new auction is lower than what the participant would have paid if it did not default, then the amount the TNSP would receive from the auction proceeds would decrease. The effect of the zero dollar reserve price means that, in the worst case scenario, the TNSP would not receive any auction proceeds from those units. If the units sold at the new auction for a higher price than originally paid by the party that defaulted, then the amount the TNSP receives from the auction would increase.

In other words, the counterparty default risk borne by TNSPs is symmetrical in a sense that if re-auctioned units sell for a higher price, they receive more auction proceeds, and if units sell for a lower price, they receive less auction proceeds.

If the participant default occurs after the last auction, AEMO would cancel the SRD agreement for those units and pay the TNSP its respective share of the positive inter-regional settlements residue which accrued to those units. No auction proceeds in relation to those units would be paid to the TNSP in this case, but it would receive the potential benefit of any positive inter-regional settlements residue related to those units.

As TNSPs are required to reduce their TUOS charges by the amount of the auction proceeds (or the payout from any non-auctioned units), the greater the value of these units, the more customers benefit. Current procedures require TNSPs to be responsible for the risk of other parties' default that they may have no information, ability or incentive to manage. The risk of loss is, therefore, passed on to customers, who may be required to pay higher TUOS charges if revenue from the auction proceeds is decreased due to a participant default.

Changes to default procedures

The introduction of secondary trading creates better opportunities for auction participants to manage their risk, by allowing for an easier way of changing their

positions. A more liquid secondary market could provide means for an auction participant in financial distress to sell its units and, therefore, improve its financial situation. This could, in theory, lead to a decrease in default risk in this market. Depending on the requirements in the NER and the auction design developed by the SRC, there can be cases where TNSPs (and as a result, customers) would need to be responsible for a shortfall in auction revenue, however unlikely.

The Commission is of the view that the proposed rule would have allowed for the development of an auction design, where the symmetry of the TNSP being able to receive higher or lower proceeds from a new auction following an auction participant default would have been altered. This is because if a secondary buyer defaulted and its units were re-auctioned for a lower price, the TNSP would have been responsible for the shortfall. However, if the new auction price was higher than the previous selling price, the TNSP would not have received higher auction proceeds as a result.

Default risk associated with secondary trading is currently managed by the auction participants. If a counterparty to a bilateral trade defaults, it does not have flow-on effect to a TNSP or its customers, as auction proceeds distributed to TNSPs remain unaffected. If secondary trading was to be facilitated by AEMO, counterparty risk originating from secondary trading may be socialised among a TNSP's customers as a result of the impacts on TNSPs. Clause 3.18.4(a2) of the proposed rule would have required TNSPs to cover the secondary seller's shortfall in revenue if the secondary buyer was unable to pay for the units it previously purchased.

The Commission understands that to date the risk of default in auctions has been low. Stakeholders submitted that such a risk continues to be immaterial and the possible effects on the TNSPs, and therefore, on its customers would not be significantly different as a result of secondary trading. However, socialising risk among the broader group of consumers would still remain a possibility.

The Commission understands that the likelihood of counterparty default remains low and that the likelihood is expected to further decrease as auction participants receive the optionality to sell their units; however, this has to be balanced against the possibility of increased speculation occurring in the market which may increase the risk of default. Any additional costs associated with increased risk management required as a result of secondary trading, in the Commission's view, is outweighed by the benefits of increased liquidity. However, it is still necessary to recognise that the risk must be managed. The draft rule therefore, requires that secondary trading auction participants bear the risk of secondary trading. Stakeholders indicated that the risk of default is not significant and therefore, is not a major risk for the TNSP to manage. The Commission is of the view, that given stakeholders views on this risk, it would be appropriate for auction participants to bear this risk. The draft rule does not set out how this risk is to be managed however, as the Commission considers the auction rules are the appropriate place for this issue to be addressed.

Therefore the draft rule does not mandate any type of risk mitigation method to be used in relation to secondary trading as these specific and technical details are best addressed by the SRC through the auction rules. As the auction rules will require amendment prior to any implementation of secondary trading, auction participants will have the opportunity to consider this issue through the rules consultation procedures, which

AEMO is required to follow if a decision is made to amend the auction rules in order to implement secondary trading.⁸⁴ However, the draft rule makes it clear that any shortfall in secondary auction proceeds cannot be recovered from a TNSP, and AEMO has no obligation to pay auction proceeds to secondary sellers where it has not received sufficient proceeds to do so.⁸⁵ Therefore, the auction rules could not be amended in a way that would be inconsistent with this requirement.

The Commission is of the view it is appropriate to allocate default risk in a way that reflects the beneficiaries of the persons receiving the auction proceeds. TNSPs are entitled to auction proceeds related to primary units and also bear the default risk associated with those units.⁸⁶ Secondary sellers are entitled to auction proceeds related to secondary units, and so they bear the associated default risk accordingly.⁸⁷

The draft rule does not alter current arrangements with respect to primary units and does not increase already existing risks for the TNSPs (and as a result, customers). This means that in case of the default of a primary buyer, units that were not sold in the secondary trading auction could still be reauctioned by AEMO. Auction proceeds stemming from the sale of primary units are payable to the relevant TNSP in all cases.⁸⁸

In relation to the case where a primary buyer defaults after reselling some or all of its units in the secondary trading auction, reauctioning by AEMO of those units is no longer possible, because of the secondary trade.⁸⁹ That is, the right to the settlements residue associated with the relevant unit has been transferred to another person. In such a case, the primary auction proceeds received by AEMO could be less than what AEMO is required to pay to the TNSP. The draft rule requires AEMO to pay to the relevant TNSP the total of the primary auction proceeds prior to paying any secondary seller. Where the total auction proceeds received by AEMO is less than the amount owed to the relevant TNSP (which the Commission recognises may not be very likely), AEMO must pay all of the auction proceeds to the TNSP.⁹⁰

The Commission is satisfied that the draft rule is likely to better contribute to the achievement of the NEO than the proposed rule. Risk allocation is considered efficient if it is being allocated to the party that has the information, ability and incentives to best manage the risks. Efficient allocation of risks in the NEM leads to lower costs for consumers as the adverse effects of default are better managed. Consumers are likely to benefit from preserving the symmetry of those that receive the benefits of auction proceeds with those that bear the risk of default.

84 See clauses 3.18.3(d)(1) and 3.18.3A(b) of the draft rule.

85 See clause 3.18.4 and particularly, paragraph (a6) of the draft rule.

86 See clause 3.18.4(a2) of the draft rule.

87 See clauses 3.18.4(a5) and 3.18.4(a6) of the draft rule.

88 See clause 3.18.4(a1) of the draft rule and the definition of "primary SRD unit".

89 The primary buyer in this case sold its units on another auction that is different and happened after the original purchase.

90 See clause 3.18.4(a3) of the draft rule.

4.4 Costs and benefits

There are some direct, easily quantifiable costs involved with the implementation of auction based secondary trading, relating to necessary IT and auction rules development. Other costs and benefits depend on whether the added value of optionality and better opportunities for optimising a portfolio across regions outweigh the indirect costs of lower auction prices result from an additional supply of units per auction.

4.4.1 Westpac's view

Westpac in its rule change request submitted that the benefits of the rule change request would likely outweigh the costs. It was of the view that the costs incurred by auction participants would increase as AEMO would pass on any increased cost of running the auction through an increase to the auction expense fees. Based on advice from AEMO, Westpac suggested that the cost of implementation would be between \$195,000 and \$285,000 which, if recovered through the auction fees of 2016 (where the total amount of auction proceeds was over \$150 million), would have increased the cost of units by 0.15 per cent⁹¹ in that year.⁹²

Westpac also noted that benefits to sellers include liquidity, anonymity, simplified execution and reduced default, credit and settlement risk, which are all extremely hard to quantify. Additionally, buyers would be able to quickly build a unit position to their desired level if required to meet shifts in risk portfolio requirements.⁹³

Westpac stated that it was unclear whether the proposed change in units would cause any shift in the value of units large enough to be distinguishable from the usual price movements and allowing the sale of units at auctions would not create an overall change in supply or demand of units and therefore should not affect the price. It, however, noted that if auction participants strongly valued the increased liquidity that sale at auction creates, then units might become fundamentally more valuable.⁹⁴

4.4.2 Stakeholder views

AGL noted that as AEMO's maximum estimate of the cost of implementation was \$285,000, even if there was little interest in secondary trading, market participants would not be left with a large implementation bill.⁹⁵

AGL was also of the view that units already purchased should not be included in any draft rule, and that only units purchased at auctions after any draft rule is implemented should be allowed to be sold into the secondary trading process, to ensure that the cost of units already purchased is not compromised. It further argued that altering the

⁹¹ In comparison the weighted average clearing price of units for the second calendar quarter of 2017 ranged between \$845 and \$32,145. A 0.15 per cent increase in those prices would have meant having to pay an additional \$13 and a \$482 per unit.

⁹² Westpac rule change request, 16 December 2017, Appendix 1, p. 4

⁹³ Ibid., p. 4

⁹⁴ Ibid., p. 4

⁹⁵ AGL submission, 17 May 2017, p. 1

settings of the remaining tranches of units may still compromise the cost of those units already purchased, as embedded in the cost attributed to the units is that there is no provision to sell units back in to the auction. As a result, AGL suggested that the rule change request should be implemented only prior to the first tranche of the units at auction, namely three years in advance. AGL did not specify whether these recommendations should be included in the NER or in the auction rules.⁹⁶

Westpac submitted that the proposed change to the NER has no cost other than the effort of participants responding to the consultation. It added that other costs could only be incurred if a change is made to the auction rules, if AEMO and the SRC go through a process which requires public consultation and must be considered in regard to contributing to the achievement of the NEO.⁹⁷

Westpac considered that secondary trading provides participants with an additional optional action to sell and, in general, increases in optionality increase value.⁹⁸

Westpac reiterated its view from its original rule change request, stating that the costs indicated by AEMO are trivial in percentage terms and are much smaller than market participants typically pay in brokerage fees, which is a proxy for the value the market places on liquidity for financial products. It considered that implementation costs could be recovered only from sellers of units, because in that case only those who valued the change would pay for implementation.⁹⁹

4.4.3 Analysis

The costs of changes to the auction rules and AEMO's IT systems to support trading can be recovered through auction fees that are paid by auction participants. These costs would add to the total cost of units, however, the recovery of these costs is likely to come from those who value and benefit most from the introduction of auction based secondary trading: auction participants.

Indirect costs and benefits are related to the value that auction participants attach to the units that can be traded in a more robust manner.

If secondary units are auctioned at the same auction as primary units are offered for sale, the supply of units at a particular auction could naturally increase. All things being equal, increased supply usually leads to lower prices. Lower unit prices could, on the one hand, reduce auction proceeds going to TNSPs, resulting in higher TUOS charges for customers. On the other hand, if units are fit for purpose in terms of being efficient hedging tools, retailers may be able to decrease their retail prices for customers, as the wholesale purchase of electricity costs would be lower. Customers, however, do not directly benefit from lower unit prices and higher payouts received by traders, as their profits typically increase the value for their private shareholders.

The Commission is of the view that the added value created by increased liquidity and the optionality of being able to sell units through the AEMO auction process is likely to

96 Ibid., p. 1

97 Westpac submission, 9 May 2017, p. 6

98 Ibid., p. 6

99 Ibid. p. 6

outweigh the possible decrease in unit prices stemming from the increased supply of units per auction.

The Commission considers that the auction rules are best placed to address the issue of deciding whether units that were sold at auctions prior to the commencement of the rule could subsequently be offered for secondary sale. The Commission understands that the benefit of additional liquidity stemming from the ability to offer those units for sale could outweigh the retrospective gain in value for those auction participants that hold those units.

4.5 Conclusion

The Commission considers that the increased liquidity of secondary trading is likely to improve the effectiveness of units as inter-regional hedging instruments. This improvement, together with the added optionality of being able to sell units is expected to create more value for auction participants, leading to higher unit prices and therefore higher auction proceeds to be distributed to the TNSPs, which in turn will lower TUOS charges for customers. This contributes to the NEO by promoting the efficient operation of electricity services for the long term interests of consumers with respect to price.

The Commission is of the view that the draft rule, which is a more preferable rule, appropriately allocates risks stemming from the introduction of auction based secondary trading by requiring those parties who have the information, ability and incentives to best manage those risks. Better managed risks mean that shortfalls following any counterparty defaults occurring in relation to secondary trading are not passed on to customers via possible higher TUOS charges. The Commission considers this is in the long-term interests of consumers in relation to price and investment in electricity services and therefore, it will, or is likely to, better contribute to the achievement of the NEO.

Abbreviations

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
ASX	Australian Stock Exchange
Commission	See AEMC
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National electricity objective
NER	National Electricity Rules
SRC	Settlement Residue Committee
TNSP	transmission network service provider
TUOS Charge	transmission use of system charge

A Summary of other issues raised in submissions

This appendix sets out the issues raised in the first round of consultation on this rule change request and the AEMC's response to each issue. If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.

Stakeholder	Issue	AEMC Response
ERM Power, p. 2	ERM submitted that the maximum number of units for each directional interconnector should be subject to change at every auction instead of the current practice where that number is based on the nominal capacity of interconnectors. ERM was of the view that instead, there should be an expected average interconnector limit based on a previously agreed methodology. It suggested that this would improve the effectiveness of units for supporting inter-regional trade.	The Commission notes that the NER does not prescribe any methodology on how the maximum number of units should be calculated. Section 4.3(d) of the auction rules requires AEMO to publish the maximum number of units, but it does not provide guidance on how those numbers should be determined. The Commission considers that underlying methodology for calculating the maximum number of units for each directional interconnector is out of scope of this rule change request, and would be best addressed through consultation on amendments to the auction rules and not by the NER.
ERM Power, pp. 2-3	ERM was of the view that the firmness of units would be greatly improved if the calculation of inter-regional settlements residue was modified in a way that TNSPs became financially responsible for the changes in inter-regional settlements residue that is caused by network outages.	The Commission considers that while this issue is relevant to the underlying value of units in general, addressing it would represent a change to the current calculation methodology of settlements residue, which would be out of scope of this rule change request.
ERM Power, p. 3	ERM noted that short selling of units should be permitted on auctions, because that would further increase liquidity and therefore the effectiveness of units as inter-regional hedging instruments.	The Commission is of the view that the permission of short selling at auctions would significantly expand AEMO's current roles and responsibilities in the NEM, with the result of AEMO effectively becoming a central clearing counterparty of auctions. The risk management practices required for this exercise, as ERM noted, would likely be similar to the operation of the ASX, including the requirement of margining and possibly daily marked-to-market evaluation of financial positions. The Commission therefore considers that allowing or mandating the operation of a financial market for AEMO would not be in

Stakeholder	Issue	AEMC Response
		line with its current responsibilities and is not an appropriate role for the market operator.
ERM Power, pp. 3-4	ERM was of the view that an offer curve should be published by AEMO after the auctions, similarly to how bid curves are published following current auctions.	The Commission notes that the NER does not prescribe what information AEMO must publish following each auction. Section 10.2 of the auction rules requires AEMO to publish details of the anonymised version of bids on its website. The Commission considers that the requirement to publish offers without identifying auction participants would be best addressed through consultation on amendments to the auction rules and not by the NER.

B Legal requirements under the NEL

This appendix sets out the relevant legal requirements under the National Electricity Law (NEL) for the AEMC to make this draft rule determination.

B.1 Draft rule determination

In accordance with section 99 of the NEL the Commission has made this draft rule determination in relation to the rule proposed by Westpac.

The Commission's reasons for making this draft rule determination are set out in section 3.4.

A copy of the draft rule, which is a more preferable rule, is attached to and published with this draft rule determination. Its key features are described in section 3.4.

B.2 Power to make the rule

The Commission is satisfied that the draft rule falls within the subject matter about which the Commission may make rules. The draft rule falls within section 34 of the NEL as it relates to "the activities of persons (including Registered Participants) participating in the national electricity market or involved in the operation of the national electricity system".¹⁰⁰

B.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the rule
- the rule change request
- submissions received during first round consultation and
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NEO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.¹⁰¹

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator (AEMO)'s declared network functions.¹⁰² The draft rule is compatible with AEMO's declared network functions as it does not impact on AEMO's declared network functions.

¹⁰⁰ Section 34(1)(a)(iii) of the NEL.

¹⁰¹ Under section 33 of the NEL, the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for Energy. On 1 July 2011 the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

¹⁰² Section 91(8) of the NEL

B.4 Civil penalties provisions

The Commission's draft rule amends clause 3.18.4(e) of the NER. This rule is currently classified as civil penalty provision under Schedule 1 of the National Electricity (South Australia) Regulations.

The Commission considers that clause 3.18.4(e) should continue to be classified as a civil penalty provision and therefore does not propose to recommend any change to its classification to the COAG Energy Council.

The Commission does not consider any other provisions of the draft rule should be classified as civil penalty provisions.

B.5 Conduct provisions

The draft rule does not amend any clauses that are currently classified as conduct provisions under the NEL or the National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the draft rule be classified as conduct provisions.