



Australian Energy Market Commission

RULE DETERMINATION

National Electricity Amendment (Negative Settlements Residue Recovery, Extension of Sunset) Rule 2009

Rule Proponent
NEMMCO

Commissioners
Tamblyn
Ryan
Woodward

16 April 2009

A handwritten signature in black ink, appearing to read "John Tamblyn", is written over a light blue circular stamp. The signature is fluid and cursive.

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For and on behalf of the Australian Energy Market Commission

RULE
CHANGE

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About the AEMC

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

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Abbreviations

AEMC	Australian Energy Market Commission
CMR	Congestion Management Review
Commission	See AEMC
IRSR	Inter-Regional Settlements Residue
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company Ltd
NEO	National Electricity Objective
Rules	National Electricity Rules
SRA	Settlements Residue Auction
SRC	Settlement Residue Committee

Executive Summary

On 23 February 2009 the Australian Energy Market Commission (Commission) received a Rule Change proposal from NEMMCO entitled “Extension of Sunset for the Recovery of Accrued Negative Settlement Residue” (Rule Change Proposal).

In the Rule Change Proposal NEMMCO requested that the Commission consider extending the savings and transitional Rule regarding the National Electricity Amendment (Negative Inter-Regional Settlements Residue) Rule 2006 (2006 Rule). NEMMCO proposed that the sunset date applicable to the current mechanism for recovery of negative settlement residues be extended by one year to 30 June 2010.

The Commission decided to expedite the Rule Change Proposal under section 96 of the National Electricity Law as it considered that the proposed Rule would be unlikely to have a significant effect on the national electricity market, because it proposes to extend the existing arrangements as a transitional measure. No objections to the expedited process were received. No submissions on the Rule Change Proposal were received.

In accordance with section 102 of the NEL the Commission has made and published this Rule determination. In accordance with section 103 of the NEL the Commission has made the National Electricity Amendment (Negative Settlements Residue Recovery, Extension of Sunset) Rule 2009 (Rule as Made) in the manner proposed by NEMMCO.

The Rule as Made will commence on 16 April 2009.

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO. The Rule as Made satisfies the Rule making test because it:

- avoids inefficiencies that would arise from reverting to the old recovery mechanism of auction fees before the Commission makes a determination on whether to make the MCE’s proposed National Electricity Amendment (Negative Inter-regional Settlement Residue Amounts) Rule 2009; and
- promotes clarity, certainty and a smooth transition between the current and any alternative IRSR recovery mechanism, thereby promoting efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers.

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1 NEMMCO's Rule Change Proposal

1.1 Proposal

On 23 February 2009 the Australian Energy Market Commission (Commission) received a Rule Change proposal from NEMMCO entitled "Extension of Sunset for the Recovery of Accrued Negative Settlement Residue" (Rule Change Proposal).

In the Rule Change Proposal NEMMCO requested that the Commission consider extending the savings and transitional Rule regarding the *National Electricity Amendment (Negative Inter-Regional Settlements Residue) Rule 2006* (2006 Rule). NEMMCO proposed that the sunset date applicable to the current mechanism for recovery of negative settlement residues be extended by one year to 30 June 2010.¹

NEMMCO submitted that the proposed Rule is non-controversial and therefore requested that the Rule-making process be expedited in accordance with section 96 of the National Electricity Law (NEL).²

1.2 Problem to be addressed by the Rule Change Proposal

If the 2006 Rule is allowed to expire on the 30 June 2009, NEMMCO will be required to recover outstanding negative inter-regional settlements residue (IRSR) from future auction fees according to the method that was used prior to 2006 Rule coming into effect. NEMMCO considers that it would be inefficient to revert back to this method because:

- the Commission is considering the *National Electricity Amendment (Negative Inter-regional Settlements Residue Amounts) Rule 2009*, which proposes a longer term mechanism for the recovery of negative settlement residues. This proposed Rule change is part of a package of rule changes requested by the Ministerial Council on Energy (MCE) as part of its response to the Commission's Congestion Management Review (CMR) Final Report;³
- it would increase the cost of funding negative residue debt to NEMMCO due to the need to finance accrued residues;
- it would increase the potential for cross subsidies between current Settlements Residue Auction (SRA) participants and future participants; and

¹ Rule Change Proposal, p.1

² Rule Change Proposal, p.1

³ Please note that the Commission is scheduled to make a draft Rule determination on the Ministerial Council on Energy's (MCE's) proposed National Electricity Amendment (Negative Inter-regional Settlements Residue Amounts) Rule 2009. See MCE Rule Change Proposal, Arrangements for Managing Risks associated with Transmission Network Congestion (Implementation of the Rule Change Recommendations of the CMR), 16 February 2009

- transitional complexities involved in reverting to the old method would be introduced unnecessarily, prior to the introduction of the new approach proposed by MCE based on the AEMC's recommendations in the Final Report for the CMR.⁴

NEMMCO also noted that the approaching relevant sunset date provides a very limited time for NEMMCO to manage the transition to any new methods arising out of the CMR Rule change request currently being considered by the Commission. The design of transitional arrangements such as the development of new systems and processes will only become clear when any new Rule is finalised, at which time the relevant sunset date will be very close, potentially leaving inadequate time for a properly managed transition.⁵

NEMMCO further noted the MCE's view that reverting back to recovering negative IRSR from auction fees would be inefficient and, if necessary, the relevant sunset date should be extended until the new recovery method could be implemented. The MCE expected that this should be given effect through a savings and transitional arrangement in the Negative Residue Draft Rule.⁶

NEMMCO discussed these matters with the Settlement Residue Committee (SRC) at its meeting on 6 February 2009. The SRC indicated that as consultation on the MCE's response to the recommendations of the CMR Final Report had not yet commenced, the SRC was concerned that the approaching relevant sunset date created uncertainty for participants as to how negative IRSR would be managed in the future. Accordingly, the SRC requested NEMMCO to progress a Rule change proposal to extend the relevant sunset date by 12 months.⁷

1.3 Proponent's Proposed Solution

NEMMCO's proposed solution is to extend the sunset date applicable to the savings and transitional Rule regarding the 2006 Rule by one year to 30 June 2010.

1.4 Consultation

On 5 March 2009, the Commission published a notice under section 95 of the NEL commencing initial consultation on the Rule Change Proposal and advising of its intention to expedite the Rule Change under section 96 of the NEL on the grounds that it is non-controversial, subject to the receipt of written objections. On 20 March 2009, the deadline for written objections closed and no objections were received.

⁴ Rule Change Proposal, p.2

⁵ Rule Change Proposal, p.2-3

⁶ Rule Change Proposal, p.3 (see also MCE, Congestion Management Review: Ministerial Council on Energy Response to Australian Energy Market Commission Final Report, November 2008, p. 3.)

⁷ Rule Change Proposal, p.3

The Commission considered that the proposed Rule would be unlikely to have a significant effect on the national electricity market as it proposes to extend the existing arrangements as a transitional measure. This will allow stakeholders to have more certainty as to which recovery mechanism will apply to negative settlements residue amounts and interest on these amounts until the Commission makes a determination on whether to make the MCE's proposed *National Electricity Amendment (Negative Inter-regional Settlement Residue Amounts) Rule 2009*.

On 3 April 2009, the submissions period for the Rule Change Proposal closed. The Commission received no submissions on the Rule Change Proposal.

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2 Rule Determination

2.1 Commission's Determination

In accordance with section 102 of the NEL the Commission has made and published this Rule determination. In accordance with section 103 of the NEL the Commission has made the *National Electricity Amendment (Negative Settlements Residue Recovery, Extension of Sunset) Rule 2009* (Rule as Made) in the manner proposed by NEMMCO.

The Rule as Made will commence on 16 April 2009.

2.2 Commission's Considerations

This Rule determination sets out the Commission's reasons for making the Rule as Made. In coming to its decision, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule as Made;
- the Rule Change Proposal and the proposed Rule;
- submissions on the proposed Rule (if any);
- the 2006 Rule and Rule Determination;⁸
- the CMR Final Report and MCE Rule Change Request in response;
- any relevant MCE statement of policy principles; and
- the Commission's analysis as to the ways in which the Rule Change Proposal will, or is likely to, contribute to the National Electricity Objective (NEO) so that the Rule making test is satisfied.

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO. The Rule as Made satisfies the Rule making test because it:

- avoids inefficiencies that would arise from reverting to the old recovery mechanism of auction fees before the Commission makes a determination on whether to make the MCE's proposed *National Electricity Amendment (Negative Inter-regional Settlement Residue Amounts) Rule 2009*; and
- promotes clarity, certainty and a smooth transition between the current and any alternative IRSR recovery mechanism, thereby promoting efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers.

⁸ AEMC 2006, *Negative Inter-Regional Settlements Residue*, Rule Determination, 30 March 2006 Sydney

2.3 Commission's power to make the Rule

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

- the matters set out in section 34(1)(a)(i), as it relates to the operation of the national electricity market; and
- the matters set out in item 34(a) of Schedule 1 of the NEL as it relates to the payment of money, including the payment of interest for the settlement of transactions for electricity or services purchased or supplied through the wholesale exchange operated and administrated by NEMMCO.

3 Commission's Assessment Against NEL Criteria

This Chapter sets out the Commission's assessment of the Rule Change Proposal and its reasons for making the Rule as Made.

3.1 Methodology

In assessing any proposed Rule change against the NEL criteria, the counterfactual arrangements against which the Rule change is being compared in light of the NEO must be considered. In the present case, the relevant counterfactual would be to revert to the recovery mechanism of auction fees that was in place prior to the introduction of the 2006 Rule.

3.2 Rule making test and the National Electricity Objective

The Rule making test states that the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO.⁹ The objective of the NEL is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- price, quality, safety, reliability and security of supply of electricity; and
- the reliability, safety and security of the national electricity system.¹⁰

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic dimensions of efficiency), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities. Of particular relevance for this Rule Change Proposal are the allocative dimensions of efficiency.

3.3 Background

3.3.1 Inter-Regional Settlements Residue

In its capacity as market operator, NEMMCO pays generators for the electricity they produce and bills market customers for the electricity they consume. Producers and market customers within a region are settled at the same price, although different prices might exist between regions. This difference creates an "inter-regional settlement residue" (IRSR). Rights to this IRSR amount are sold by NEMMCO through a settlements residue auction (SRA) and are used by participants as a hedging instrument.

⁹ See section 88(1) of the NEL

¹⁰ See section 7 of the NEL

A positive IRSR is created when electricity flows from a lower-priced region to a higher-priced region. Sometimes the dispatch produces an outcome in which electricity flows from a higher-priced region to a lower-priced region as a result of network constraints. This will create a “negative” settlement residue.

Although clause 3.6.5(a)(4)(i) of the Rules is currently inactive, both it and clause 3.6.5(4A)(i) which currently replaces it, allow NEMMCO to recover the negative IRSR amounts from the positive IRSR amounts arising in the same billing period.¹¹ If the net of positive and negative IRSR amounts is negative for the billing period, the Rules currently provide different recovery arrangements, depending on whether the negative IRSR arose between 1 July 2006 and 30 June 2009 or after this time.

During the period commencing 1 July 2006 and ending 30 June 2009, clause 3.6.5(a)(4A)(ii) allows NEMMCO to recover any IRSR amount remaining unrecovered from the proceeds of the first auction after that billing period. Where this amount is insufficient, clause 3.6.5(a)(4A)(iii) allows NEMMCO to recover the outstanding amount from proceeds of successive auctions until the negative amount is recovered.¹²

During this same period clause 3.6.5(a)(4B) also allows NEMMCO to recover the interest costs incurred in relation to unrecovered negative IRSR amounts from the proceeds of first auction after that billing period and then, if required, from the proceeds of successive auctions.

As it did prior to 1 July 2006, after the end of 30 June 2009 clause 3.6.5(c) reinstates clause 3.6.5(a)(4) so that NEMMCO is to recover any net negative IRSR left after the billing period from future auction expense fees (not proceeds). These fees are paid by persons eligible to participate in the settlements auction. Clause 3.6.5(a)(4)(ii) allows NEMMCO to recover any net negative IRSR from the network service providers who would have received positive IRSR amounts, were it not for NEMMCO’s recovery of negative IRSR amounts.

3.3.2 Negative Inter-Regional Settlements Residue Rule 2006

Prior to the 2006 Rule, negative IRSR amounts were recovered from future auction fees. Under the 2006 Rule, clause 3.6.5 (a)(4A) requires NEMMCO to recover negative IRSR amounts from future auction proceeds, thereby reducing:

- the cost of funding of negative residue debt, including interest payments; and
- cross subsidies that occurred between current auction participants and future ones. These cross subsidies occurred because the previous recovery method used to take up to three years to fully recover negative IRSR accrued on a certain day. Therefore, SRA unit holders were paying for market outcomes that occurred up to three years earlier.

¹¹ A billing period begins with the first trading interval on a Sunday and ends on with the last trading interval on a Saturday.

¹² See also clause 11.1(c) of the Rules.

At the time of making the 2006 Rule, the Commission noted a number of issues raised by participants concerning the SRA and inter-regional financial trading arrangements in the National Electricity Market (NEM) and indicated that these would be more appropriately addressed in the CMR (see below section). Consequently, the Commission inserted a sunset clause (clause 3.6.5.(c)) into the Rules which was intended to limit "...the application of this new regime to three years from its commencement."¹³ Hence, these provisions (particularly rule 11.1) were included with the intention of providing stakeholders the opportunity to consider longer term solutions.

3.3.3 Congestion Management Review

Following its review of congestion management in the NEM the Commission published the CMR Final Report on 16 June 2008. Included in the CMR Final Report was the draft *National Electricity Amendment (Negative Inter-Regional Settlements Residue Amounts) Rule*. This proposed Rule includes proposed amendments to the Rules concerning the funding of negative settlement residues. The Commission is currently considering this proposed Rule as part of the MCE rule change request responding to the output of the CMR.

3.3.4 Smooth Transition

NEMMCO considers that reverting to the old method prior to the introduction of the new approach proposed by the Commission in its Final Report would introduce unnecessary transitional complexities.¹⁴

NEMMCO also notes that the approaching point in time at which the sunset provision will expire the current arrangements for recovering negative IRSR provides a very limited time for it to manage the transition to the method proposed in the Commission's CMR Final Report.¹⁵ The design of transitional arrangements such as the development of new systems and processes will only become clear when the Rule proposed by the MCE in response to the CMR Final Report is finalised, at which time the sunset period will be very close, potentially leaving inadequate time for a properly managed transition.

3.3.5 Inefficiency

Responding to the recommendations contained in the CMR final Report the MCE stated that:

... it would be inefficient to revert to the old recovery mechanism of auction fees and therefore the current sunset should, if necessary, be extended until

¹³ AEMC 2006, *Negative Inter-regional Settlements Residue*, Rule Determination 30 March 2006, Sydney Rule 2006, p2.

¹⁴ Rule Change Proposal, p.2

¹⁵ Rule Change Proposal, p.2-3

the new recovery mechanism can be implemented. This should be given effect through a savings and transitional arrangement in the Negative Residue Draft Rule ...¹⁶

NEMMCO considers that it would be inefficient to revert back to the old recovery mechanism of auction fees because:

- the Commission is shortly expected to commence consultation on the MCE's proposed *National Electricity Amendment (Negative Inter-regional Settlement Residue Amounts) Rule* which proposes a longer term mechanism for the recovery of negative settlement residues;
- it would increase the cost of funding negative residue debt to NEMMCO due to the need to finance accrued residues, including interest payments; and
- it would increase the potential for cross subsidies between current SRA participants and future participants.¹⁷

3.3.6 Market Uncertainty

NEMMCO reported that, at its meeting on 6 February 2009, the SRC indicated to NEMMCO that as consultation on the MCE's response to the recommendations of the CMR Final Report had not yet commenced, it was concerned that the approaching point in time at which the sunset provision will expire the current arrangements for recovering negative IRSR created uncertainty for participants as to how negative IRSR would be managed in the future.

3.4 Comment

No submissions were received during the consultation period for this Rule change.

The Commission notes:

- the background and circumstances relating to the Rule Change Proposal;
- the issues raised by NEMMCO and by the MCE in its response to the CMR Final Report regarding the need to avoid inefficiency that would arise from reverting to the old recovery mechanism of auction fees; and
- the potential for uncertainty amongst market participants as to how negative IRSR would be managed, given the pending sunset of the 2006 Rule, the Rule changes recommended in the CMR Final Report and the MCE's response.

The Commission acknowledges and accepts that to revert back to the old recovery mechanism of auction fees would impede a smooth transition to any alternative

¹⁶ MCE, Congestion Management Review: Ministerial Council on Energy Response to Australian Energy Market Commission Final Report, November 2008, p. 3.

¹⁷ Rule Change Proposal, p.2

approaches, would be inefficient and may lead to uncertainty amongst market participants.

3.5 Assessment against Rule making test

The Commission has analysed and assessed the Rule Change Proposal. The Commission considers that, until any alternative mechanisms are introduced the Rule as Made will enable NEMMCO to continue to deliver the existing arrangements for managing negative IRSR without the need to revert back to arrangements that were in place prior to 2006.

The Commission is satisfied that the Rule as Made will, or is likely to, contribute to the achievement of the NEO. The Rule as Made satisfies the Rule making test because it:

- avoids inefficiencies that would arise from reverting to the old recovery mechanism of auction fees before the Commission makes a determination on whether to make the MCE's proposed *National Electricity Amendment (Negative Inter-regional Settlement Residue Amounts) Rule 2009*; and
- promotes clarity, certainty and a smooth transition between the current and any alternative IRSR recovery mechanism, thereby promoting efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers.