

15 April 2008

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Dear John,

Submission on the Exposure Draft Rule changes arising from the Congestion Management Review

Thank you for the opportunity to comment on the above Exposure Draft Rule Changes which the Commission has drafted to reflect its recommendations arising from the Congestion Management Review (CMR).

NEMMCO understands that the Commission is seeking comments only on the effectiveness of the Rule drafting in giving effect to the recommendations in the CMR, and is not seeking further comment on the substance of the recommendations themselves. We have therefore focused our comments accordingly. In summary, the more material issues fall into the following areas:

- **Negative Inter-Regional Settlement Residues:** The draft Rule based mechanism for recovery of negative settlement residues directly from Transmission Network Service Providers (TNSPs) does not specify what NEMMCO should do if payment by TNSPs is late or not made at all. This, together with any prudential mechanisms should be clearly set out in the Rule to a similar level of detail as is covered for other energy market payments.
- **Fully Co-optimised and Alternative Constraint Formulations:** a number of minor issues have been identified.
- **Congestion Information Resource:** While the proposed Rule allows NEMMCO to update the information resource, no guidance is provided in the Rule as to the frequency of updates, or as to whether the process is intended to be one of continuous improvement toward the stated objective.

More detailed comments on the proposed Rule drafting, including the primary issues noted above, are contained in the Attachment to this letter.

We look forward to the Commission's consideration of our submission. Please contact Murray Chapman on (02) 9239 9106 if you wish to discuss this submission.

Yours sincerely,


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**NEMMCO Submission on CMR Exposure Draft Rules
Attachment – detailed comments**

NEMMCO has reviewed the exposure draft Rules from the perspective of effective implementation of the Commission's recommendations from the CMR. The following comments are offered in that regard. The comments are structured to address each of attachments 1 to 3 of the exposure draft Rules in turn.

1 Appendix A: Negative inter-regional settlements residue rule

The Commission is proposing in recommendation 3 of the CMR that NEMMCO should recover negative settlements residue amounts directly from the TNSP in the importing NEM region. Appendix A of the exposure draft seeks to give effect to this recommendation by empowering NEMMCO to recover accrued negative settlements residues from the TNSP in the importing region. NEMMCO has identified the following potential issues with the proposed recovery mechanism and the proposed Rule drafting.

1.1 Short payment and prudential arrangements

The recovery of potentially large sums of money from TNSPs introduces the risk of late payment or non-payment of those settlement amounts by the TNSP, particularly if the recovery is carried out as part of the normal NEM settlement cycle. NEMMCO notes that draft Rule 3.6.5(a)(4)(ii) would allow NEMMCO to recover negative settlements residue from TNSPs using a different cycle from the current NEM settlement cycle. The following discussion considers the issues associated with establishing the new recovery regime, and makes some preliminary observations for consideration by the Commission.

By way of background, market participants are required to lodge financial guarantees with NEMMCO in accordance with the prudential provisions set out in clause 3.3 of the Rules. Under the NEM prudential process, market participants are required to maintain their total outstandings within a defined trading limit from day to day, and if they fail to do so a default process can be initiated by NEMMCO. This process aims to keep the participant's total outstandings within the level of their guarantee. If a payment due to NEMMCO is not cleared on settlement day, a default event occurs, and NEMMCO is permitted to draw on the relevant Market Participant's guarantee to make payment to Market Participants to whom money is owed two hours later. The market participant could be suspended from trading in the market if the default is not rectified. In the event of a shortage of funds, NEMMCO would have no alternative but to short-pay the Market Participants to whom money is owed, under Rule 3.15.22(c).

The proposed Rule for recovery of negative settlements residue from TNSPs does not appear to protect the market against the event of late payment or non-payment by TNSPs. The proposed mechanism, therefore, increases the probability that NEMMCO might need to short-pay Market Participants under Rule 3.15.22(c).

There are a number of differences between the settlement of market participants and the recovery of money from TNSPs that could have a bearing on the solution to this issue. NEMMCO has identified the following options for consideration by the Commission:

- a) **TNSP participation in the NEM Prudential Regime:** this assumes TNSPs would be settled in line with the normal settlement cycle, and would require TNSPs to be allocated a maximum credit limit (MCL) and trading limit. Each TNSP would then

lodge a bank guarantee with NEMMCO, and be required to keep its total outstandings below the trading limit. In the event of late payment, NEMMCO could call on the bank guarantee. Such a regime would reduce the risk of late payment by a TNSP resulting in short payment of Market Participants, but the process might not be as efficient as other options due to the cost of bank guarantees. The mechanism may also not be as effective as it is for Market Participants, depending on how the notion of suspension from trading would apply to a TNSP. It is also likely to be quite difficult under this regime to determine the MCL to apply to a TNSP, due to the unpredictable timing and quantum of negative settlements residues.

- b) **Withholding some payment from TNSPs as collateral:** Under this option, NEMMCO would withhold an amount of cash out of the settlements residue auction (SRA) proceeds that are payable to TNSPs. NEMMCO would be required to invest the money on behalf of the TNSPs, as is currently done on behalf of market participants who lodge security deposits with NEMMCO. This approach would avoid the inefficiency of making payment to banks, but would retain the uncertainty involved in determining an appropriate amount to retain as collateral.
- c) **Reverting to the current approach as a backup mechanism:** this approach would also involve settling normally with TNSPs each billing week, but if payment is not received on time NEMMCO would be required to finance the negative settlements residue payment until the money can be recovered from future auction proceeds. This would be a material variation from the current approach of routinely funding negative settlements residues from auction proceeds, as it would require a form of "on-call" line of credit sufficient to cover the potential extent of negative settlement residues. NEMMCO has not explored the availability or cost of such facilities with banks or Governments at this stage, but there might be a material cost involved if it is feasible at all. NEMMCO does not recommend this option due to the reliance on a short notice line of credit making it likely to be more expensive than other approaches.
- d) **Early clearing or prudential coverage of funds by TNSP:** under the current settlement cycle, NEMMCO issues preliminary settlement statements to Market Participants 5 business days after the end of the billing week. Funds are not settled until 20 business days after the end of the billing week. The interim period of about 3 weeks is used by the market for reconciliation purposes, but it would provide an opportunity for TNSPs to provide NEMMCO with cleared funds or a bank guarantee to cover any amount owing to NEMMCO in the preliminary statement – eg there could be a requirement for cleared funds to be paid within (say) 5 business days of the preliminary settlement statement being issued. The funds would still be settled on the normal settlement day (20th business day), together with any variations due to adjustments that occur in the interim. This would allow TNSPs to be settled in accordance with the normal settlement cycle, but avoid the need for additional prudential arrangements. If cleared funds were not provided by the required date NEMMCO could be required to finance the shortfall until proceeds were available from the next auction (as there will be time to arrange finance prior to settlement day), or alternatively short pay the Market Participants NEMMCO is required to pay on settlement day. If NEMMCO is required to finance a shortfall during an interim period, it is critical for a backup funding source to be specified (such as auction proceeds), otherwise an unfunded liability could arise.
- e) **Introducing a new TNSP settlement cycle:** as noted above, the draft Rule makes provision for NEMMCO to determine a different payment interval for recovery of negative settlements residue from TNSPs. This approach may allow

negative residues to be recovered in advance of the normal settlement day (which is 20 business days after the end of the relevant billing week). Such an approach would permit NEMMCO to respond to the non-payment by a TNSP, by drawing on a line of credit as is done now. In such cases NEMMCO would finance the negative settlements residues for settlements purposes, and would seek to recover it from the relevant TNSP at the earliest opportunity. If recovery from the TNSP cannot be effected, a backup arrangement for funding the amount would be needed. A suitable backup may be to allow NEMMCO to recover the money from future auction proceeds and / or future intra-regional settlements residue that would otherwise be paid to that TNSP. This recovery would need to include the interest.

Of these options, NEMMCO considers that options d) and e) are both viable. They both have the potential to minimise inefficiency and risk. It is recommended that the Commission consult the TNSPs when considering these options. In order to implement these options, NEMMCO considers that some changes to the draft Rule would be necessary, including:

- A mechanism requiring TNSPs to provide cleared funds based on the preliminary settlement statement (option d);
- Clarity as to the process NEMMCO is required to follow in determining the alternative TNSP settlement cycle. It may be appropriate for the TNSP settlement cycle to be included in the timetable under clause 3.4.3 (option e); and
- A backup provision that allows NEMMCO to recover funds from future auction proceeds and / or from future payments due to the TNSP, such as intra-regional settlements residues if necessary (options d and e).

These options may not be exhaustive, and there may also be variations to them that the Commission can generate or that come from other submissions. NEMMCO considers however, that it is important for the matter of late payment or non-payment by TNSPs to be addressed in the Rule, including the actions NEMMCO is required to take in such events. This is important to ensure that the outcomes of such an event are fully understood by all parties, and that risks are appropriately allocated.

1.2 Apparent discretion in recovery from TNSPs

Clauses 3.6.5(a)(4) and 3.6.5(a)(4A) in the exposure draft indicate that NEMMCO **may** recover negative settlements residue from the TNSP in the importing region. The “may” seems to imply that NEMMCO has some discretion in this matter, but the Rule gives no guidance on how that discretion should be exercised by NEMMCO. Furthermore, there is no indication in the policy material or the recommendation that a discretion is intended. NEMMCO therefore suggests that it is more appropriate to remove the impression of discretion by substituting “must” for “may” in these clauses.

1.3 Appropriate Transmission Network Service Provider

Clauses 3.6.5(a)(4) and (4A) allow NEMMCO to recover negative residues from the “appropriate Transmission Network Service Provider ... within the region (the importing region) ...”. This raises the question of which TNSP is the appropriate TNSP to make the payment, and how that should be determined where more than one TNSP (excluding Market Network Service Providers) is registered in respect of a particular region.

This is a practical issue as demonstrated by the number of TNSPs registered in respect of the NSW region (currently 3) and the Victoria region (currently 2). It is acknowledged that this is also an issue with the drafting of the existing clause 3.6.5, however the uncertainty would be perpetuated under the proposed new drafting, and will take on greater significance in light of the increased amounts that will need to be recovered from the TNSPs. The matter is currently dealt with co-operatively, however the Rules give little certainty to the matter being resolved effectively should it be challenged.

It is therefore suggested that the drafting be clearer as to which TNSP negative residues should be recovered from. This could be done through nominating the TNSP responsible, or by setting out a process through which the responsible TNSP can be determined by an appropriate party and advised to NEMMCO.

1.4 Obligation for TNSPs to pay

Although clause 3.6.5(a)(4) gives NEMMCO a power to recover negative settlements residue from TNSPs, a corresponding obligation for TNSPs to make the necessary payment is not expressed in the Rule. Clause 3.6.5(b) treats TNSPs as Market Participants for the purposes of clause 3.15, which in turn, deals with settlements, however, clause 3.15.12 refers to “amounts payable” under Chapter 3. Although the obligation for TNSPs to pay is implied, NEMMCO suggests that this obligation be made clear and binding.

1.5 Other drafting issues

- Depending on the resolution of issues raised in section 1.1 of this submission, further connections to the existing settlement processes set out in Rule 3.15 may be required as follows:
 - Explicit inclusion of negative settlements residue in the scope of clause 3.15.1(a). This could be achieved by the addition of a new clause 3.15.1(a)(4) “Settlements residue under clause 3.6.5.”
 - Clarification of the proposed clauses 3.6.5(a)(4)(ii) and 3.6.5(a)(4A)(ii) to ensure they are enforceable.
 - Clause 3.6.5(5)(ii) reads: “the importing region must, pay a charge to the exporting region ...” It may be more effective for the drafting to be specific as to which Market Participant party in the importing region is required to pay, and which Market Participant in the exporting region is entitled to receive the payment.

2 Appendix B: Fully co-optimised and alternative constraint formulations Rule

2.1 Reference to “variables”

The proposed definition of a *fully co-optimised direct physical representation network constraint formulation* is: “A network constraint equation formulation that allows NEMMCO to control all the variables within the equation.” Use of the term “variables” in this definition is quite non-specific, and may benefit from refinement for use in the

Rules. This is because any of the terms in a constraint equation could be considered a variable, even those that are not under the control of the dispatch algorithm, such as regional demand or generation inertia. NEMMCO understands the intention of this definition, which has been in use outside the Rules for some time, is that all the variables in the equation that can be controlled through the central dispatch process should be allowed to be optimised. If that is the case an improved definition might be: "A network constraint equation formulation that allows NEMMCO to control all the variables that can be determined through the central dispatch process".

2.2 Other drafting issues

NEMMCO has identified the following general drafting issues with the material in Appendix B of the exposure draft:

- The new concept of a fully co-optimised direct physical representation network constraint formulation appears to be defined in two places – once in clause 3.8.10(b) and also in the Glossary. A single concise definition in the Glossary is preferable. A further comment on this aspect of the drafting is that the defined term is particularly long and awkward – it would be more practical to make the defined term shorter eg fully co-optimised network constraint formulation, and leave the reference to "direct physical representation" to be part of the definition of that term.
- Clause 3.8.10(c) requires NEMMCO to consult in accordance with Rule 8.9. Elsewhere in the Rules, there has been a practice to require consultation in accordance with the Rules Consultation Procedures – eg see Rule 3.9.3(b) and Rule 4.8.9(b) as examples. There may be merit in maintaining consistency in one approach or the other in these circumstances.
- Clause 3.8.10(e): Part (ii) of this clause appears to be also contained within part (iii). It is not clear what distinction is intended between these two clauses, but part (iii) appears to be more precise in its language and may be preferable.

3 Appendix C: Congestion Information Resource (CIR) Rule

NEMMCO understands the draft Rule on establishment of a CIR would require the following actions to be carried out by NEMMCO:

- Within 6 months of Commencement of the CIR Rule, NEMMCO would be required to publish an interim CIR that meets the requirements of clause 11.X.2.
- Also within 6 months of Commencement of the CIR Rule, NEMMCO would be required to develop and publish the first CIR Guidelines that meet the requirements of clause 3.7A(j).
- Within 12 months of Rule Commencement, NEMMCO would be required to publish the first CIR to meet the requirements of clause 3.7A(b).
- Amend the CIR from time to time in accordance with 3.7A(c).
- Publish the information in the CIR at intervals consistent with the CIR Guidelines and the timetable (clauses 3.7A(d-e)).

NEMMCO makes the following observations in respect of this process.

3.1 Content of the CIR

Clause 11.X.2 is specific as to what information is to be included in the interim CIR. Clause 3.7A(b), however, is general as to what information is to be included in the final version of the CIR, and appears to omit some of the material that is required to be in the interim version – the following are examples of this:

- Clause 11.X.2(b)(4)(i) an assessment of the projected impact of intra-regional power transfer capabilities ...; and
- Clause 11.X.2(b)(4)(ii) which requires a similar assessment in respect of inter-regional power transfer capabilities.

It appears odd for the interim CIR to be more comprehensive than the final version. This may not have been the Commission's intent, but would benefit from clarification prior to proceeding.

3.2 Ongoing development of the CIR

Clause 3.7A(c) requires NEMMCO to develop and amend from time to time the CIR. While this clause requires the CIR to be consistent with the CIR objective, there are no guidelines as to what might trigger an amendment of the CIR. If the Commission has any expectations such as a program of continuous or incremental improvement measured against the objective, it would be beneficial for this to be reflected in the Rule.

3.3 Definition of “mis-pricing”

The proposed definition of “mis-pricing” is “the difference between:

- a) the *settlement amount*; and
- b) the *dispatch price* that would occur based on *dispatch bids* and *dispatch offers*,

calculated for each *regional reference node*”.

This definition does not appear to match with the Commission's intention for mis-pricing to be an indicator of the effects of intra-regional congestion. This is because the *settlement amount* is a payment amount expressed in \$ for a market participant, while the *dispatch price* is a unit price expressed in \$/MWh for a region. The numerical difference between them is not meaningful.

Furthermore, the *settlement amount* is dependent on consumption and includes a range of components in addition to the payment for energy, such as ancillary service prices and pool fees – see Rule 3.15.12. In contrast, the *dispatch price* represents the price of energy alone.

The Commission's CMR Draft Report refers to mis-pricing at a particular network node as relating to the difference between the regional reference price and an estimate of the energy price at the network node. If this is the nature of mis-pricing that the Commission is seeking to have reported in the congestion information resource, a definition along the following may be more appropriate:

“for a particular network node within a nominated region, the difference between:

- a) the *regional reference price* for the region; and
- b) an estimate of the marginal energy price at the network node.”

3.4 Updating the timetable for the Interim CIR

Clause 11.X.2(f) requires NEMMCO to determine the frequency of updating and publishing the interim CIR and to include the outcomes in the timetable. Updating the timetable under Rule 3.4.3(b), however, requires NEMMCO to consult in accordance with the Rules consultation procedures. The requirement to consult on the frequency of updates appears to be at odds with the concept of this interim CIR, particularly since the content of the interim is explicit in the Rule. The Commission may wish to consider making the minimum update frequency explicit in the Rule, or providing an exemption from the requirement of clause 3.4.3(b) for the purpose of the interim CIR.

3.5 Other drafting issues

- In clause 11.X.2(b)(3)(ii), the reference to “extent of works” is unclear. This terminology is often used in describing construction programs. It is suggested that reference to a “description of work being carried out” may be more appropriate.