

SETTLEMENTS RESIDUE AUCTION RULES – SECONDARY TRADING

FINAL REPORT AND DETERMINATION

Published: **January 2019**





NOTICE OF FINAL DETERMINATION – SETTLEMENTS RESIDUE AUCTION RULES – SECONDARY TRADING

National Electricity Rules – Rule 8.9

Date of Notice: 30 January 2019

This notice informs all Electricity Market Registered Participants, Intending Participants and interested parties that the Settlements Residue Committee have approved the amendments to the Settlement Residue Auction Rules (Auction Rules) to implement secondary trading. This includes amendments to the Auction Participant Agreement and Settlements Residue Distribution Agreement.

This approval is in accordance with 3.18.5(b)(2) of the National Electricity Rules (NER), where AEMO has conducted the consultation in accordance with the Rules consultation requirements detailed in rule 8.9 of the NER.

The new version of the Auction Rules and associated agreements is targeted to be in effect from 1 July 2019. AEMO will publish a notice at least 15 business days prior to the effective date to make the Auction Rules.

© 2019 Australian Energy Market Operator Limited. The material in this publication may be used in accordance with the [copyright permissions on AEMO's website](#).



EXECUTIVE SUMMARY

The publication of this Final Report and Determination informs participants that the Settlements Residue Committee (SRC) have approved the amendments to the Settlements Residue Auction Rules (Auction Rules) and associated agreements for AEMO to implement secondary trading under the National Electricity Rules (NER).

Implementation of secondary trading will allow participants to offer units that they have previously purchased in a subsequent auction. If the unit is cleared in that auction, AEMO will cancel the unit and pay the holder the clearing price for cancellation.

AEMO published a Consultation Paper to commence the first stage of consultation on 21 September 2018, and a Draft Report and Determination to commence the second stage of consultation on 29 November 2018. These papers discussed the proposed changes and mechanisms to implement secondary trading in the Settlements Residue Auction (SRA), including:

- The mechanisms to facilitate secondary trading via the SRA;
- The collateral requirements for those making offers at a loss;
- The approach to close-out due to termination;
- Project cost expectations and the approach to fees; and
- Transitional matters.

AEMO received three submissions to the first stage of consultation, which raised the following issues and proposals:

- An alternative approach to collateralising units by incorporating the margin requirements into the existing NEM framework;
- Concerns that the number of available units will not be known prior to the bidding close, and a proposed alternative for offers to be made public prior to the auction opening;
- Expectations for the project costs to remain within the estimate provided by AEMO, and for impacts to existing participant systems and processes to not be fundamentally modified; and
- Expectations regarding the fee determination (with support noted for the new fee approach).

AEMO considered these issues and prepared the Draft Report and Determination that the approaches proposed originally more effectively meet the National Electricity Objective (NEO). AEMO received one additional submission to the second stage of consultation, which noted support for incorporating the margin requirements into the existing NEM framework. AEMO has considered this approach, and is unable to change this approach due to regulatory restrictions given that the NER keeps these frameworks separate.

Having considered the matters raised in submissions, AEMO and the SRC's final determination is to amend the Auction Rules in the form of Attachment 1, in accordance with clause 3.18 of the NER.

This is as per the Auction Rules that were published with the Draft Report and Determination, with one additional typographical error rectified in the Auction LP published in Schedule 2.



CONTENTS

NOTICE OF FINAL DETERMINATION – SETTLEMENTS RESIDUE AUCTION RULES – SECONDARY TRADING	1
EXECUTIVE SUMMARY	2
1. STAKEHOLDER CONSULTATION PROCESS	4
2. BACKGROUND	4
2.1. NER requirements	4
2.2. Context for this consultation	4
2.3. First stage consultation	5
2.4. Second stage consultation	5
3. SUMMARY OF MATERIAL ISSUES	6
4. DISCUSSION OF MATERIAL ISSUES	6
4.1. Alternative management of exposure through existing prudential framework	6
5. OTHER MATTERS	7
6. FINAL DETERMINATION	7
APPENDIX A. GLOSSARY	8
APPENDIX B. SUMMARY OF SUBMISSIONS AND AEMO RESPONSES	9
APPENDIX C. AUCTION RULES	10



1. STAKEHOLDER CONSULTATION PROCESS

As required by clause 3.18 of the NER, AEMO has consulted on the implementation of secondary trading in the SRA in accordance with the Rules consultation process in rule 8.9.

AEMO's indicative timeline for this consultation is outlined below. Future dates may be adjusted depending on the number and complexity of issues raised in implementation, and ASIC approval of licensing exemptions.

Deliverable	Indicative date
Notice of first stage consultation and Consultation Paper published	21 September 2018
NEM Wholesale Consultative Forum Presentation	26 September 2018
First stage submissions closed	30 October 2018
Draft Report & Notice of second stage consultation published	29 November 2018
Submissions due on Draft Report	14 December 2018
Final Report and Auction Rules circulated to SRC for approval	21 December 2018
Final Report published	30 January 2019
Notice of effective date	Prior 10 June 2019 for 1 July 2019 implementation.
Effective date of the Auction Rules	Indicative: 1 July 2019

Note that there is a glossary of terms used in this Draft Report at Appendix A. References in this paper to 'rule x' is a reference to an NER rule; the word 'clause' has been used to refer to specific clauses in the amended Auction Rules or Auction Participation Agreement.

2. BACKGROUND

2.1. NER requirements

Under rule 3.18.3 of the NER, AEMO is responsible for developing and amending the Auction Rules that set out the procedures and mechanisms for operating the SRA. Rule 3.18.3(d)(1) stipulates that AEMO may amend the Auction Rules with the approval of the SRC and in accordance with the Rules consultation process outlined in rule 8.9. This consultation is conducted in accordance with rule 3.18.3(d)(1) which allows AEMO to amend the Auction Rules to implement secondary trading by setting out the requirements specified in rule 3.18.3(a1).

2.2. Context for this consultation

On 10 October 2017, in response to an NER Rule change proposal submitted by Westpac Banking Corporation (Westpac), the Australian Energy Market Commission (AEMC) made a final determination to change the NER to enable AEMO, with the approval of the Settlements Residue Committee (SRC), to provide a platform for secondary trading of settlements residue distribution units (units). The AEMC's determination considered secondary trading will improve liquidity in units, which in turn is likely to increase interstate trade of electricity, improve risk management, and increase competition in retail and wholesale markets.¹

¹AEMC, 2017, "Secondary trading of settlement residue distribution units rule change". Available: <https://www.aemc.gov.au/rule-changes/secondary-trading-of-settlement-residue-distributi> Viewed: 19 September 2018



AEMO developed a high-level design in conjunction with the SRC, incorporating all necessary requirements of the final NER determination. In May 2018, based on this design, initial estimates and implementation timelines, the SRC endorsed secondary trading to be implemented in the SRA.

2.3. First stage consultation

AEMO issued a Notice of First Stage Consultation on 21 September 2018. AEMO prepared a Consultation Paper to consult with industry on proposed changes and mechanisms to implement secondary trading in the Settlements Residue Auction (SRA). This paper is available on AEMO's website at: http://aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/Electricity_Consultations/2018/SRA/ConsultationPaper_AuctionRules_SecondaryTrading_200918.pdf.

In summary, key amendments proposed to the Auction Rules, the Auction Participation Agreement (APA), and the Settlements Residue Distribution Agreement (SRDA) involve:

- Introduction of the ability for participants to offer units they currently hold in a future auction.
- The ability for AEMO to cancel distribution payments to the holder of units cleared in the future auction.
- A requirement for AEMO to pay the participant offering the unit the relevant portion of auction proceeds if the unit is cleared (a payment for cancelling distribution payments). The participant remains obliged to pay AEMO the original allocation price.
- Changes to the auction solver to include offers.
- A requirement for participants to provide cash security as margin if they are offering units at a loss compared to the initial allocation price of the units, and associated calculations.
- Amendments to the participant termination close out processes, to distinguish between units held by a participant and cancelled units on default.
- Changes to the auction expense fee structure to include a fee for trading a unit via the SRA secondary trading platform.

AEMO received three written submissions in the first stage of consultation. Copies of all written submissions have been published on AEMO's website at: <http://aemo.com.au/Stakeholder-Consultation/Consultations/SRA-Secondary-Trading-Consultation?Convenor=AEMO%20NEM>

AEMO also presented to the NEM Wholesale Consultative Forum on 26 September 2018 to discuss the proposed amendments. Minutes of that meeting have been published on AEMO's website at: <http://www.aemo.com.au/Stakeholder-Consultation/Industry-forums-and-working-groups/Wholesale-meetings/NEM-Wholesale-Consultative-Forum>

2.4. Second stage consultation

AEMO issued a Notice of Second Stage Consultation on 29 November 2018. AEMO prepared a Draft Report and Determination to discuss the material issues that had been raised in the first stage of consultation. This paper is available on AEMO's website at: http://aemo.com.au/-/media/Files/Stakeholder_Consultation/Consultations/NEM-Consultations/2018/SRA/DraftReport-SRASSecondary_29Nov2018.pdf

In summary, key issues that were discussed included:

- An alternative approach to collateralising units by incorporating the margin requirements into the existing NEM framework;
- Concerns that the number of available units will not be known prior to the bidding close, and a proposed alternative for offers to be made public prior to the auction opening;



- Expectations for the project costs to remain within the estimate provided by AEMO, and for impacts to existing participant systems and processes to not be fundamentally modified; and
- Expectations regarding the fee determination (with support noted for the new fee approach).

AEMO considered these issues and published a Draft Report and Determination noting that AEMO's consideration is that the approaches proposed originally more effectively meet the National Electricity Objective (NEO).

AEMO received one written submission to the second stage of consultation. Copies of all written submissions have been published on AEMO's website at: <http://aemo.com.au/Stakeholder-Consultation/Consultations/SRA-Secondary-Trading-Consultation?Convenor=AEMO%20NEM>

3. SUMMARY OF MATERIAL ISSUES

The key material issues arising from the proposal and raised by Consulted Persons across each stage of consultation are summarised in the following table:

No.	Issue	Raised by	Consultation stage
1.	Publication of available units	AGL	1
2.	Collateralising units offered at a loss	AEMO, Origin and Snowy Hydro	1
3.	Alternative management of exposure through existing prudential framework	Origin and EnergyAustralia	1 and 2
4.	Close-out due to termination	AEMO	1
5.	Project cost expectations	AEMO and Snowy Hydro	1
6.	Expected modifications to participant systems and processes	AEMO and Snowy Hydro	1
7.	SRA cancellation fee determination	AEMO, Origin and Snowy Hydro	1
8.	Transitional considerations	AEMO and AGL	1
9.	Change process	AEMO and Snowy Hydro	1

A detailed summary of issues raised by Consulted Persons in submissions to the second stage of consultation together with AEMO's responses, is contained in Appendix B.

4. DISCUSSION OF MATERIAL ISSUES

No new material issues were raised in the second stage of consultation. AEMO has discussed the issues raised in the first stage of consultation in the Draft Report and Determination. The following discusses issues raised in the submission to the second stage of consultation.

4.1. Alternative management of exposure through existing prudential framework

4.1.1. Issue summary and submissions

AEMO proposes that the margin requirements are met by participants providing cash security. Origin raised an alternative proposal in their submission to the first stage of consultation to manage a participant's exposure through the existing prudential framework. EnergyAustralia submitted to the second stage of consultation to agree with Origin's proposal, as well as noting that use of cash margin rather than bank guarantees may reduce the liquidity and benefits of the secondary market.



4.1.2. AEMO's assessment

Regulatory restrictions prevent incorporation of the margin into the NEM framework at this time. The NEM framework has specific response and close-out provisions associated with the prudential arrangements, suited to the NEM framework and the risks to which that market is exposed. The NER keeps these separate to reduce the impact of secondary trading in the SRA on the NEM. If participants consider separate cash security is a barrier to participation in SRA secondary trading going forward, they may submit a NER Rule change request.

AEMO has also considered the ability to use bank guarantees as well as cash security to fulfil the margin requirements. However, it was determined that this would result in a more complex (and therefore more expensive) implementation. In line with the guiding principles from the SRC to implement simply, the approach was chosen to fulfil the requirements of margin by cash security only. This could be revisited following implementation if it is considered to be a barrier to trade.

4.1.3. AEMO's conclusion

For market start, AEMO will continue with implementing the cash security framework for the purposes of collateralising units offered at a loss.

5. OTHER MATTERS

A typographical error has been identified in Schedule 2 of the Auction Rules, in the specification of the Auction LP. Equation (5), which is the dual LP, is missing a variable in the final term. The equation has been corrected to read:

$$\sum_i \left(\sum_{\substack{o \\ \text{where } l_o=i}} u_o \right) \omega_i + \sum_b q_b^{\max} \lambda_b + \sum_o u_o \alpha_o$$

6. FINAL DETERMINATION

Having considered the matters raised in submissions, AEMO has sought and received the SRC's approval to amend the Auction Rules, in accordance with clause 3.18 of the NER.

**APPENDIX A. GLOSSARY**

Term or acronym	Meaning
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
APA	Auction Participation Agreement. The template agreement is an appendix to the Auction Rules.
Auction Rules	Settlements Residue Auction Rules
IRSR	Inter-regional Settlements Residue. Also referred to as 'residue'
NER	National Electricity Rules
SRA	Settlements Residue Auction
SRC	Settlements Residue Committee
SRDA	Settlements Residue Distribution Agreement. The form of this agreement is stipulated in the APA.
TNSP	Transmission Network Service Provider
units	Settlements Residue Distribution units.

APPENDIX B. SUMMARY OF SUBMISSIONS AND AEMO RESPONSES

No.	Consulted person	Issue	AEMO response
1.	EnergyAustralia	<p>EnergyAustralia agrees with Origin's proposal in their submission to the consultation paper. That is, AEMO should continue to use participants existing trading margin to determine if the secondary SRAs present a credit risk at the time of the auction. If additional margin is required, AEMO can ask for further bank guarantees to be secured before allowing trading of secondary SRAs. As Origin highlights, participants are already familiar with this platform and have internal systems and process in place to manage AEMO's existing credit procedures.</p> <p>While EnergyAustralia is generally supportive of the proposed changes in the draft report, EnergyAustralia is concerned that requiring participants to utilise cash margins (as oppose to bank guarantees) may reduce the liquidity and benefits of the secondary market.</p>	<p>Regulatory restrictions prevent incorporation of the margin into the NEM framework at this time. If participants consider this is a barrier to participation in SRA secondary trading going forward, they may submit a NER Rule change request.</p> <p>The choice to implement with cash security only to fulfil the margin requirements was made to simplify the implementation of secondary trading. If participants consider that this is a barrier going forward, AEMO welcomes them to contact AEMO or the SRC to consider this further post implementation.</p>



APPENDIX C. AUCTION RULES

The final Auction Rules and Auction Participation Agreement is published on AEMO's website:

<http://aemo.com.au/Stakeholder-Consultation/Consultations/SRA-Secondary-Trading-Consultation>

A notice of effective date will be published at least 15 business days prior to the changes coming into effect.