

Final Determination

Applications for Authorisation

National Electricity Code

Settlements Residue Auction Process

Date: 22 December 1999

Authorisation nos:

A90688
A90689
A90690

File nos: C1999/90-92

Commissioners:

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Summary

On 20 May 1999, NECA lodged applications for authorisation relating to changes to the National Electricity Code (NEC) (Nos: A90688, A90689, and A90690) to enable an auction of portions of the settlements residue¹ to be undertaken by NEMMCO. The applications were submitted by NECA on behalf of itself, NEMMCO and all participants in the NEM. The applications were submitted under Part VII of the *Trade Practices Act 1974* (the Act). Amendments to the applications were received on 24 May 1999. The Commission granted interim authorisation to the amended applications on 16 June 1999. NECA submitted further amendments to the applications on 22 June 1999 and 9 November 1999. A Draft Determination outlining the Commission's analysis and views on the authorisation applications was issued on 27 October 1999.

Authorisation under Part VII of the Act provides immunity from court action for certain types of market arrangements or conduct which would otherwise be in breach of Part IV of the Act, where the Commission concludes that the public benefits of the arrangements or conduct would outweigh the anti-competitive detriments of such arrangements or conduct.

Inter-regional settlement residue arises when there is a constraint on one of the interconnectors between the different National Electricity Market (NEM) regions. Whenever an interconnect is constrained, there is price separation in the two adjoining regions, as the price in each will be set by the highest marginal generator required to be dispatched to meet the physical electricity supply needs of that region.

Power flowing over the interconnect will be sold at the exporting region's (lower) price and purchased at the constrained importing region's (higher) price, creating a settlements residue equal to the difference between the two prices times the amount of power flowing over the constrained interconnect. Such price differences can pose a significant financial risk to NEM participants undertaking inter-regional trades. The settlements residue can be used to hedge such price risks and hence facilitate inter-regional trade. Under the NEC, the settlements residue is to be paid to transmission network service providers who are required to return it to customers through lower transmission use of system charges.

In its 10 December 1997 Determination, the Commission accepted the importance of inter-regional trade for the overall integrity and efficiency of a national market for wholesale trade in electricity. This is because inter-regional trade can enhance competition by adding competitors to regional markets. While acknowledging the importance of inter-regional hedges (IRHs), the Commission did not authorise the proposed central provision of IRHs through an IRH exchange to be facilitated by NEMMCO, noting that this proposal did not represent the minimum required to commence a market in IRHs.

¹ Over the course of the Code's development, the settlements residue has also been referred to as settlements surplus, 'black hole money' and 'link revenue'.

The Commission has prepared this Determination outlining its analysis and views on the key competition issues arising from the applications for authorisation of the settlements residue auction process. The current applications were made under sub-section 88(1) of the *Trade Practices Act 1974* for authorisation to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act; and to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of the Act. The applications were also made under sub-section 88(8) of the Act for an authorisation to engage in conduct that constitutes, or may constitute, the practice of exclusive dealing.

According to the applicants, the settlements residue auction process is designed to:

- facilitate inter-state trade in electricity, and
- increase retail competition by giving retailers the ability to manage inter-regional trading risks.

Following consideration of the arguments advanced by the applicants, the Commission considers that the auction process may involve some anti-competitive detriment, primarily due to:

- the exclusion of some NEM participants from the auction process; and
- NEMMCO's power to impose a reserve price.

Overall, the Commission is satisfied that significant public benefits will arise from the introduction of a settlements residue auction process. Implementation of the proposed arrangements should result in NEM participants being better able to manage financial risks inherent in inter-regional trading. Enhanced inter-regional trading will facilitate competition in the retail markets of each region and possibly contribute to lower energy prices for consumers.

The Commission considers that the public benefits are sufficient to outweigh any anti-competitive detriment that may arise from the settlements residue auction process, and proposes to grant authorisation to the proposed arrangements. Accordingly, this Determination sets out the Commission's decision to grant authorisation in respect of applications A90688 A90689 and A90690.

The Commission proposes to limit the current authorisation of the settlements residue auction process to 31 December 2002, with the ability to set reserve prices terminating earlier. The ability to set reserve prices is to exist only in relation to auctions for the settlements residue that accrues up to and including 31 December 2001. That is, the ability to set reserve prices will terminate after the auctions relating to the October to December quarter of 2001. The Commission further proposes to limit the participation of Snowy Hydro Trading Pty Limited (SHT) in the auction process to demonstrated need for inward residues plus five percent. This condition is reviewable in 12 months time should SHT so request.

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Glossary

The Act	<i>The Trade Practices Act 1974</i>
Bardak	Bardak Energy Services
Commission	Australian Competition and Consumer Commission
Ergon Energy	Ergon Energy (Victoria) Pty Ltd and Ergon Energy Pty Ltd
Hedging	taking steps to protect against, or reduce, the risk of exposure to variations in the spot price.
IRH	Inter-regional Hedge
IRSR	Inter-regional Settlements Residue
MNSP	Market Network Service Provider
MW	Megawatt
NEC	National Electricity Code
NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company Ltd
NSP	Network Service Provider
SHT	Snowy Hydro Trading Pty Limited
SMHEA	Snowy Mountain Hydro Electric Authority
SRA	Settlements Residue Auction
SRC	Settlements Residue Committee
SRD	Settlement Residue Distribution
TNSP	Transmission Network Service Provider
TUOS	Transmission Use of System

1. Introduction

1.1 The application

On 20 May 1999, NECA lodged applications for authorisation (A90688, A90689, and A90690) for changes to the National Electricity Code to enable an auction of portions of the inter-regional settlements residue (IRSR) to be undertaken by NEMMCO. The applications were submitted by NECA on behalf of itself, NEMMCO and Code Participants in the National Electricity Market.

The IRSR arises in the NEM where prices between regions diverge, due to losses or constraints on inter-regional electricity flows. Such price divergence can pose a significant financial risk to NEM participants undertaking inter-regional trades. The IRSR can be used to hedge such risks and hence facilitate inter-regional trade.

The applications were made under sub-section 88(1) of the *Trade Practices Act 1974* for an authorisation to make a contract or arrangement, or arrive at an understanding, a provision of which would have the purpose, or would or might have the effect, of substantially lessening competition within the meaning of section 45 of the Act; and to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of the Act. The Applications were also made under sub-section 88(8) of the Act for an authorisation to engage in conduct that constitutes, or may constitute, the practice of exclusive dealing.

The applications are only concerned with the arrangements and provisions set out in the settlements residue auction code changes. However, much of the detail of the proposed arrangements are set out in other related documents, the Settlements Residue Auction Rules and Auction Participation Agreements.

In its 10 December 1997 Determination on the NEC, the Commission recognised the importance of inter-regional trading to the efficiency of the NEM. However, in that Determination the Commission expressed concern that the inter-regional hedge provisions proposed did not represent the minimum required to facilitate the emergence of inter-regional trade. Hence the establishment of an IRH exchange by NEMMCO was not authorised and instead the Commission recommended the applicants develop and implement a proposal under which NEMMCO would take a minimum facilitation role. The current auction proposal represents one means of facilitating inter-regional hedging.

1.2 Statutory test

These applications were made under sub-sections 88(1) and 88(8) of the Act. The Act provides that the Commission shall only grant authorisation if the applicant(s) satisfies the relevant tests in sub-sections 90(6) and 90(8).

Sub-section 90(6) provides that the Commission shall grant authorisation only if it is satisfied in all the circumstances that:

- the provisions of the subject arrangements or conduct would result, or be likely to result, in a benefit to the public; and
- that benefit would outweigh the detriment to the public constituted by any lessening of competition that would, or would be likely to result from the arrangements or conduct.

Sub-section 90(8) provides that the Commission shall grant authorisation only if it is satisfied in all the circumstances that the proposed provision or conduct would result (or be likely to result) in such a benefit to the public that the proposed contract, arrangement, understanding or conduct should be allowed.

In deciding whether it should grant authorisation, the Commission must examine the anti-competitive aspects of the arrangements or conduct, the public benefits arising from the arrangements or conduct and weigh the two to determine which is greater. Should the public benefit or expected public benefits outweigh the anti-competitive aspects, the Commission may grant authorisation or grant authorisation subject to conditions.

Determining what is a public benefit is therefore a key issue. Public benefits recognised in the past include:

- fostering business efficiency;
- industry rationalisation;
- expansion of employment;
- promotion of industry cost savings;
- promotion of competition in industry;
- promotion of equitable dealings in the market;
- development of import replacements;
- growth in export markets; and
- arrangements which facilitate the smooth transition to deregulation.

If the Commission determines that the public benefits do not outweigh the anti-competitive detriment, the Commission may refuse authorisation or alternatively, in refusing authorisation, indicate to the applicants how the applications could be constructed to change the balance of detriment and public benefit so that authorisation may be granted.

The value of authorisation for the applicant(s) is that it provides protection from action by the Commission or any other party for potential breaches of certain restrictive trade

provisions of the Act. It should be noted, however, that authorisation only provides exemption for the particular conduct applied for. Authorisation does not provide blanket exemption from all provisions of the Act. Further, authorisation is not available for misuse of market power (section 46).

1.3 Public consultation processes

Prior to presentation to the Commission as an application for authorisation, the proposed changes to the NEC were developed using the Code Consultation Procedures set out in Chapter 8 of the NEC. As a registered interested party, the Commission was kept informed of issues and concerns raised by Code Participants as part of that process.

The Commission received the initial application for authorisation of the Settlement Residue Auction (SRA) process on 20 May 1999. NEMMCO and NECA provided the Commission with submissions in support of the applications. NECA amended its applications on 24 May, 22 June, and 9 November 1999. These documents were placed on the public register for inspection by interested parties. The Commission granted interim authorisation (subject to certain conditions) to the proposed changes on 16 June 1999.

Under the Act the Commission has a statutory obligation to follow a public process when assessing an application for authorisation. Accordingly, the Commission requested submissions from interested parties by way of advertisement in *The Australian* dated 31 May 1999 and on the Commission's web page. Interested parties were asked to make submissions to the Commission regarding their views on the issues of public benefit and anti-competitive detriment arising from implementation of the proposed changes. Eight interested parties provided submissions (see Appendix). All submissions have been placed on the Commission's public register. These submissions are discussed in detail in Chapter 4 of this Determination.

The Commission produced a Draft Determination outlining its analysis and views on the authorisation applications on 27 October 1999. The Commission invited interested persons to notify it within 14 days of the release of the Draft Determination as to whether the applicants or other interested persons wished the Commission to hold a conference in relation to the Draft Determination.² Snowy Hydro Trading Pty Limited notified the Commission of its desire for a pre-determination conference on 3 November 1999.

The pre-determination conference was held in Canberra on 11 November 1999. Representatives of ten interested parties attended the conference.

² For the purposes of the conference, an interested person is a person who has notified the Commission in writing that the person, or a specified unincorporated association of which the person is a member, claims to have an interest in the applications and the Commission is of the opinion that the interest is real and substantial.

Following the conference, interested parties were given the opportunity to present further submissions to the Commission. The Commission received six submissions addressing issues raised at the conference or in the Draft Determination. This Determination takes into account the issues raised at the pre-decision conference and in submissions.

The Commission has released this final Determination outlining its analysis and views on the amended NEC according to the statutory assessment criteria set out in section 1.2. A person dissatisfied with the final Determination may apply to the Australian Competition Tribunal for its review.

2. Settlements residue auction proposal

The purpose of the settlements residue auction process is to enable risk management by providing participants with access to inter-regional hedges in the form of rights to specified portions of the settlements residues. The IRSR is split into six directionally-specific inter-regional settlement residue units. Each of these units reflects the directional flow of electricity across interconnectors between the regions for a particular quarter.

The proposed arrangements for the settlements residue auction are set out as amendments to the NEC, the auction rules and the auction participation agreements. The applicants have only applied for authorisation of the amendments to the NEC, but the rules and participation agreements form an essential component of the structure of the proposed arrangements. It is important to note that immunity from prosecution conferred by the authorisation process will only apply to the components of the settlements residue auction process which are actually specified in the NEC amendments.

2.1 Settlements residue

The IRSR arises because transmission losses and constraints on interconnections create a mismatch between the monies received from market customers and those paid to generators as a result of the settlements process. In relation to transmission losses, differences exist between losses priced into the dispatch and settlements process and actual losses for flows of electricity between regional reference nodes.

For the purposes of the auction, the IRSR is divided into ‘units’, each unit representing the inter-regional price difference relating to 1MW of energy flow in a particular direction between two regions. The units relate to six different inter-regional flows:

- NSW to Snowy;
- Snowy to NSW;
- Victoria to Snowy;
- Snowy to Victoria;
- Victoria to South Australia; and
- South Australia to Victoria.

Inter-regional trading in the NEM is subject to risk where contracts reference a pool price in a region outside the contracting party’s region. The inter-regional risk is the price difference between the two regions multiplied by the volume of exposure. Partitioned into units that represent definable volumes of energy between particular regions, the IRSR can be used as a non-firm hedge for inter-regional energy transactions.

2.2 Changes to the NEC

The changes to the NEC set out that:

- NEMMCO may conduct settlements residue auctions, in accordance with the auction rules;
- Only those that meet the eligibility criteria set out in the rules may participate in the auctions;
- NEMMCO has the power to suspend, or remove a suspension, on auctions for one or more of the directional interconnectors;
- NEMMCO must develop the auction rules, which must include:
 - Criteria for eligibility;
 - Procedures for conducting auctions;
 - Timing of auctions;
 - Mechanisms for calculating the clearing price;
 - Mechanisms for calculating fees;
 - Billing and settlements procedures;
 - The standard form of auction participation agreement;
- NEMMCO may also incorporate a reserve price for each directional interconnector;
- NEMMCO must structure the auctions to maximise the value of the settlements residues;
- NEMMCO must establish procedures for the distribution of settlements residues and collection of auction proceeds and fees;
- NEMMCO must establish a Settlements Residue Committee (SRC) (clause 3.18.5);
- Only a fixed portion of the settlements residue will be available for auction, with the remainder of the available residue and auction proceeds being distributed to the transmission network service providers (TNSPs) (clause 3.18.4(a)). The settlements residues will be allocated as follows:
 1. giving full effect to Chapter 9 derogations (clause 3.6.5(a)(1));
 2. making payments to regulated interconnectors (clause 3.6.5(a)(2)); and
 3. distributing remaining residues to Transmission Network Service Providers (TNSPs) (clause 3.6.5(a)(3));

- Auction proceeds and unsold settlements residue is to be distributed to importing TNSPs to be passed on to customers by using the money to reduce transmission network charges (existing clause 3.6.5 and proposed clause 3.18.4). In this way, the commercial trading of the residue in the market will still result in a settlements residue distribution that is transparent, can be universally applied, and is equitable, as consumers will receive a benefit via reduced transmission charges.
- Information regarding auction clearing prices, bids and the proceeds of each auction are to be published after each auction (clause 3.13.5A).

2.3 Auction rules

The auction rules set out in detail the procedures for conduct of the settlements residue auctions, including:

- Participation criteria;
- Definition and quantum of units to be auctioned for each directional interconnector;
- Auction timetable;
- Reserve price determination methodology;
- Bidding procedures;
- Allocation of units;
- Determination of the clearing price; and
- Procedures for notification of auction results and fees.

2.4 Auction participation agreements

Auction participation agreements will be entered into between NEMMCO and each participant wishing to bid in the settlements residue auctions. The agreements set out that a successful bid in an auction means that NEMMCO and the bidder have entered into a settlements residue distribution agreement (SRD Agreement). A SRD agreement specifies the purchase price and distribution rights that arise from the successful bid. The auction participation agreements also set out:

- Dispute resolution procedures;
- Liability limitations and waivers;
- Termination procedures; and
- Other general terms and conditions.

3. Competitive impact

3.1 Public benefits

Facilitation of inter-state trade and efficient use of the IRSR

The applicants claim that the physical limitations on the transfer of electricity between regions, and the way in which these limitations are incorporated in NEM dispatch and pricing rules results in significant financial risks for inter-regional trade. The applicants state that the principal objective of the auction process is to provide the basis for a hedge for market participants who trade in electricity (and associated financial products) between regions in the NEM.

By facilitating a means for market participants to manage the risks of inter-state trade, the applicants contend that the auction process is intended to promote inter-state trade and enhance competition and market efficiency in the wholesale and retail markets for electricity in the participating jurisdictions, as well as the market for related financial products.

The applicants state that public benefits arise from the facilitation of inter-state trade in electricity, and from increased retail competition arising from the better ability of retailers to manage inter-regional trading risks. The applicants also claim that follow-on benefits will arise from increased competition in the NEM and retail markets. This competition should lower end use prices which will potentially benefit households and industry. The applicants note that increasing retail competition will facilitate reforms as more end users become contestable.

The applicants also submit that the auction process provides a more efficient use of the IRSR than current arrangements, because the IRSR can be used to lower both energy prices (by making the IRSR available as an inter-regional hedging tool) and transmission use of system charges (by distributing the IRSR auction proceeds through TNSPs to network users via the NEC provisions).

3.2 Anti-competitive detriment

Some of the potentially anti-competitive elements of the proposed changes identified by the Commission are:

- *Limited Auction Participation:* Clause 3.18.2(1)(b) limits participation in the auction process to those registered under the NEC as Generators, Market Customers or Traders;³

³ A new clause 2.8A is proposed to be included which defines a Trader as a person registered with NEMMCO as a Trader in order to participate in auctions.

- *Pricing arrangements:* NEMMCO is given the power to set a reserve price in relation to each block of settlement residue sold for a particular region and clause 3.18.3(a)(3) and clause 3.18.3(b)(3) contemplates the setting of a common clearing price. NEMMCO's submission states that the common clearing price is set at the lowest bid price in respect of which inter-regional settlements residue is sold; and
- *NEMMCO's discretion with respect to rule changes:* NEMMCO is given discretion to develop rules governing auctions (clause 3.18.3 and clause 3.18.3(e)) provide that NEMMCO must develop and amend the auction rules in accordance with the Code Consultation Procedures. However, clause 3.18.3(f) provides a significant exception and states changes to the auction rules can be made by a three-quarters majority of the 'Settlements Residue Committee' when viewed as 'urgent', or for any reason within three months of the conduct of the first auction.

4. Commission considerations

This section outlines the Commission's evaluation of the proposed IRSR auction process in accordance with the statutory test as set out in section 1.2 of this Determination. Issues identified by the Commission and/or raised in submissions are:

- Limitations on auction participation;
- Pricing arrangements;
- NEMMCO's discretion and rule change processes; and
- South Australian distribution of the settlements surplus and exclusion of ETSA Power from auction processes.

4.1 Public benefits

In its 10 December 1997 Determination the Commission accepted that inter-regional trade is important to the overall integrity and efficiency of a national market for wholesale trade in electricity. The Commission still holds this view. That Determination rejected the central provision of an IRH exchange by NEMMCO because the Commission was of the view that the provisions in that version of the Code did not represent the minimum required to commence a market in IRHs. The current proposal gives NEMMCO a lesser role than central provision of an IRH exchange. The SRA process does not involve NEMMCO in secondary trading of IRHs or require NEMMCO to develop and sell inter-regional contracts. The Commission believes that the SRA proposals submitted for authorisation facilitate inter-regional hedging, as required by the 10 December 1997 Determination.

The Commission accepts that being able to hedge the price separation between adjacent regions in the NEM reduces trading risk and thus increases the potential for inter-regional trade in electricity. The Commission agrees that the facilitation of inter-state trade should result in a benefit to the public, with greater competition leading to greater economic efficiency and potentially lower energy prices.

This benefit should arise through an increased ability to manage the price risks associated with inter-state trade on the part of generators and retailers. As such, the benefits may manifest themselves in both increased retail competition in each region of the NEM and possibly lower energy prices, reflecting lower risk management costs.

The Commission notes that, in addition to enhancing available inter-regional hedging mechanisms, the IRSR auction process enables the IRSR auction proceeds to be used to deliver benefits to customers through the reduction of transmission use of system (TUOS) charges in accordance with the Commission's 10 December 1997 Determination.

4.2 Anti-competitive detriment

NECA submitted these changes to the NEC for authorisation under Part VII of the Act. Other documents relating to the Settlements Residue Auction process, namely the Auction Participation Agreements and the Auction Rules, do not form part of the applications and hence do not receive immunity from the Act. Therefore, some of the conditions imposed in this Determination ensure that anti-competitive detriment that is immune from the Act is specifically referred to in the NEC provisions presented for authorisation.

4.2.1 Limited auction participation

Clauses 3.18.2(b) and 3.18.3(a)(1) give NEMMCO broad powers to set criteria that define the ‘eligible persons’ that may bid in the auctions for the settlements residue. NEMMCO has indicated that these provisions of the NEC will be used to create auction rules that exclude:

- current South Australian generators from participating in the settlements residue auctions in respect of imports of electricity into South Australia from Victoria;
- transmission network service providers from participating in settlements residue auctions.

The auction rules also allow for exclusion from the settlements residue auctions where prospective participants:

- are not party to an auction participation agreement; or
- have defaulted on payment obligations, either in respect of auction participation agreements or NEC obligations; or
- are believed by NEMMCO to be acting for or in concert with a participant that would otherwise be excluded from participating in the settlements residue auctions.

Issues for the Commission

The exclusion of parties including South Australian generators and transmission network service providers (TNSPs) from the auction process may breach section 45 by constituting an exclusionary provision or by substantially lessening competition.

The Commission considers that the exclusion of defaulting parties, of those who are not bound to the Auction Participation Agreements and those believed to be acting in concert with excluded parties reflects sound commercial practice, and do not raise any competition concerns.

What the applicants says

NEMMCO states that the purpose of the participation restrictions is to ensure that the inter-regional settlements residue can be acquired by persons likely to use it to support inter-state trade in electricity.

NEMMCO states the participation of South Australian generators in the auction process for residues flowing from Victoria to South Australia would defeat the primary objective of facilitating competition in retail markets in South Australia. This is because the South Australian generators have the ability to influence the regional spot price for electricity through their bidding strategies. The vesting contract arrangements in South Australia attempt to remove some of the incentive for South Australian generators to attempt to set high spot prices. However, as spot prices are a determinant of the inter-regional settlements residue, allowing South Australian generators to participate in auctions for the residue relating to flows from Victoria into South Australia creates an incentive for the generators to attempt to drive spot prices in South Australia to very high levels, so as to maximise the value of the settlements residue. NEMMCO states that this is likely to inhibit rather than promote competition. Further, NEMMCO states that the purchase of the settlements residue rights by South Australian generators would place South Australian generators in a position to control contracting in relation to the supply of electricity in South Australia.

NEMMCO also notes that restricting South Australian generators from participating in the settlements residue auction in respect of South Australian imports does not restrict the generators from participating in any other settlements residue markets, including any secondary markets that may develop.

In a similar fashion, NEMMCO states that, as owners of regulated interconnectors, TNSPs have the ability to influence the flow of electricity across the interconnector, and thus the value of the settlements residue. NEMMCO state that this is likely to inhibit rather than promote competition. With an ability to influence the size of the settlements residue, NEMMCO argues that TNSPs could have an incentive to bid to acquire the settlements residue for their own benefit, rather than making the residue available for use as an inter-regional hedge.

On 9 November 1999, NECA submitted a further amendment to the application limiting the operation of clause 3.6.5 to the allocation and distribution of settlements residue to *regulated* interconnectors. The effect of this is that Market Network Service Providers (MNSPs) are excluded from the allocation of settlements residue in the event that auctions for the settlements residue related to a particular interconnector do not clear.

Issues arising from the Draft Determination

The Commission proposed the following condition of authorisation in its Draft Determination:

- C4.1 Clause 3.18.2 of the NEC must be amended to state that the eligibility criteria set out in the auction rules may only exclude:*
- (a) persons that have not entered into an auction participation agreement; or*
 - (b) transmission network service providers; or*
 - (c) persons registered under the Code as Generators and licensed to generate electricity under the Electricity Act 1996 (South Australia) or exempted from the requirement to obtain such a license, as at 1 January 1999, but*

only in relation to bidding and purchasing units of settlements residues relating to the Victoria to South Australia directional interconnector; or

- (ca) the Snowy Mountains Hydro Electric Authority, registered under the Code as a Generator, but only in relation to bidding and purchasing units of settlements residues relating to the New South Wales to Snowy directional interconnector and the Victoria to Snowy directional interconnector; or*
- (d) persons who have defaulted on payment obligations under an auction participation agreement or otherwise under clause 3.15.21 of the NEC; or*
- (e) any person acting on behalf of or in concert with a person described in paragraphs (a) to (d) above.*

Condition 4.1 was imposed to ensure greater transparency by including the exclusions from participation in the Code itself rather than in external documents (Auction Rules). This was also done to eliminate the ability to introduce further restrictions on participation through terms and conditions in documents outside the NEC such as the Auction Rules and the Auction Participation Agreements.

NECA submitted amendments to clause 3.18.2 on 22 June 1999 to meet the condition of interim authorisation (C4.1) set out above. The exclusion of the Snowy Mountain Hydro Electric Authority (SMHEA) from participation in relation to bidding and purchasing units of settlements residue relating to the NSW to Snowy directional interconnector and the Victoria to Snowy directional interconnector was not a condition of interim authorisation. This condition (clause 3.18.2(ca)) was proposed in the Commission's Draft Determination.

What interested parties say

Exclusion of transmission network service providers

NECA's code change of 9 November 1999 excluding MNSPs from the provisions of clause 3.6.5 resulted in discussion of whether or not networks should be eligible to participate in the settlement residue auction process.

TransGrid argued that the same arguments for the exclusion of TNSPs apply to MNSPs, because of their ability to limit overall interconnection capacity between regions by reducing or withdrawing their own capacity. Also, TransGrid argued that where TNSPs wished to establish business activities that stand apart from the provision of prescribed transmission network services, existing ring fencing requirements should be sufficient protection against any concerns of information crossover between transmission and trading functions.

Exclusion of South Australian generators

ETSA Power and the Department of Treasury and Finance, Electricity Reform and Sales Unit (South Australia) supported the exclusion of any generator that has market power in its particular region (ie the ability to set or influence price in a tight supply demand region). ETSA Power states that a generator purchasing the rights to the settlements residue of a region where it can influence price has an additional incentive to attempt to maximise the pool price in its own region. This is because the greater the

difference between the two pool prices of the directional settlements residue purchased, the greater the financial reward.

ETSA Power point to three detrimental effects of higher than necessary pool prices:

1. Diminished incentive to provide contracts into the wholesale market;
2. Increased pool price volatility and retailer risk; and
3. Unacceptable financial risks to retailers at times of high system demand.

Exclusion of Snowy Hydro Trading Pty Limited

At the pre-determination conference, SHT argued that it should not be excluded from participation as it does not have an ability to exercise market power. Highlighting the historically comparatively low pool price in the Snowy region as evidence of this, SHT argued that when there is a constraint the Snowy region is included in either the NSW or Victoria regions where it competes against other generators. SHT argued that the NSW generators have just as much ability to exercise market power as SHT. This argument was supported by TransGrid and Delta Electricity.

SHT also stated that it does not have an ability to exercise market power as the NSW/Snowy/Victorian regions are normally not in a tight supply/demand balance (compared with South Australia and Queensland). As the constraints either side of Snowy rarely operate together, SHT is part of one or other region, with little ability to set the pool price within that region.

SHT also argued that it does not have an incentive to game the residue as the residue is its primary risk management tool – and costs associated with risk management would have to be passed onto customers. SHT further noted that it has no load in its region and must contract with participants in other regions. In order to back its contracts SHT states that it must buy inter-regional hedges, which it claims puts it at a comparative disadvantage compared with generators in other regions who have load.

In addition to arguing an inability to influence spot prices in its region, SHT argued that its needs access to the settlements residue flowing into the Snowy region for its normal operations. In particular, it indicated that it requires 670MW for pumping which it uses for risk management purposes, and to provide cheaper prices for customers (low cost energy is purchased off-peak and sold on-peak). SHT also stated that it is a natural provider of risk management products and this would become more difficult if the SHT was excluded from bidding for inward residues, and further would also impact on its exposure to VoLL and to outage risks.

SHT also emphasised that it is ring fenced from the operation of the transmission network by the SMHEA.

Commission considerations

The limits on participation in the SRA process are intended to ensure that parties do not unfairly capture the benefits of the settlements residue auction proceeds because of their ability to influence the settlements residue.

As a condition of its interim authorisation, the Commission required that the criteria for exclusion from the auction process be specified as part of clause 3.18 of the NEC, rather than residing in documents outside the NEC such as the Auction Rules and the Auction Participation Agreements. The Draft Determination and this final Determination similarly require that any criteria for exclusion from participation are explicitly stated in the NEC to ensure transparency and clarity.

Exclusion of transmission network service providers

The Commission considers that the exclusion of this category of participant will enhance the public benefits arising from the conduct of the settlements residue auctions. This is because it will enable the residue to be made available to parties that wish to utilise the hedging properties of the IRSR, rather than allowing the IRSR to be bought by those that are well placed to influence its future value.

TNSPs have the ability to directly influence the constraints applying to interconnectors and thus the volume of electricity dispatched through an interconnector at a particular time. This will directly impact upon the residue outcome. The Commission understands that an MNSP linking the same two regions as a TNSP may have the power to limit the regulated interconnector's capacity and influence the pool price by reducing or withdrawing its own capacity. However, given the 31 December 2002 expiration date of this authorisation and the current immaturity of MNSP projects the Commission will not exclude MNSPs from bidding in the SRAs at this stage.

While a condition of authorisation relating to the participation of MNSPs is not being imposed, depending upon the degree to which an MNSPs activities can influence flows across regulated interconnectors and prices between regions, their future ability to participate in SRAs as a purchaser of units of IRSR may be reviewed.

The Commission considers that where a TNSP has established business activities which stand apart from the provision of prescribed transmission network services, such as market network services, then subject to meeting the ring fencing requirements set out in the Commissions *Draft Statement of Principles for the Regulation of Transmission Revenues*, the service provider should not be prevented from participating in auctions in relation to such services. The ring fencing requirements set out in the *Draft Statement of Principles for the Regulation of Transmission Revenues* will require the accounting and legal separation of businesses providing regulated transmission network services and market network services.⁴

Exclusion of South Australian generators

In relation to South Australian generators, their ability to influence the South Australian regional spot price is significant because the South Australian/Victorian interconnector is frequently constrained. As a result, marginal generators in South

⁴ Ring fencing provisions are discussed in Chapter 13 of the *Draft Statement of Principles for the Regulation of Transmission Revenues*, May 1999.

Australia can set the regional price and thus have a direct influence on the size of the settlements residue. If they have rights to the residue for energy flows imported into South Australia, they have both the incentive and the ability to inflate both the spot price and thus the residue outcome.

Exclusion of Snowy Hydro Trading Pty Limited

The Commission accepts SHT's contention that once a constraint has been created between the Snowy region and either the NSW region or Victorian region, Snowy has as much market power as any other generator. However, whether or not SHT may predict the existence of a constraint at a future time or increase the probability of a constraint at a future time through its bidding strategies, in particular through its ramp rate, is an issue which has not been conclusively determined. The Commission is therefore of the view that this is a subject that requires caution, as it may endow SHT with an advantage in bidding for and acquiring settlements residues that is not shared by other potential bidders.

The Commission accepts that SHT has a need for access to settlements residue relating to flows of electricity into the Snowy region from NSW and Victoria, therefore a total ban on acquiring these residues seems inappropriate. The Commission therefore imposes a condition of authorisation that SHT is to acquire inwards residues only to the amount not exceeding their audited needs, plus five percent.

The Commission's restriction on SHT's participation in the auction process does not prevent it from participating in other markets for inter-regional hedges, including any secondary market that may develop in relation to the inter-regional settlements residue. Further provision is made for this condition to be reviewed in 12 months time should SHT so request.

Conditions of authorisation

C4.1 Clause 3.18.2 of the NEC must be amended to state that the eligibility criteria set out in the auction rules shall only exclude the following categories of persons:

- (a) persons that have not entered into an auction participation agreement;
or**
- (b) transmission network service providers; or**
- (c) persons registered under the Code as Generators and licensed to generate electricity under the Electricity Act 1996 (South Australia) or exempted from the requirement to obtain such a license, as at 1 January 1999, but only in relation to bidding and purchasing units of settlements residues relating to the Victoria to South Australia directional interconnector; or**
- (d) persons who have defaulted on payment obligations under an auction participation agreement or otherwise under clause 3.15.21 of the NEC;
or**

- (e) any person acting on behalf of or in concert with a person described in paragraphs (a) to (d) above.

C4.2 This condition relates to settlements residue arising from the New South Wales to Snowy directional interconnector and the Victoria to Snowy directional interconnector only. The maximum amount of units that may be acquired by Snowy Hydro Trading Pty Limited (SHT), registered under the Code as a Generator, is to be no greater than the audited need for that settlements residue as demonstrated by existing contracts entered into by SHT. SHT may bid an additional five percent above these audited requirements. The audited report is to:

- (a) be prepared by an independent auditor, taking into account demonstrated pumping needs and contractual exposure to quantify the approximate capacity equivalent of inward-flowing settlements residue required by SHT to hedge its financial risk in each future auction quarter; and
- (b) be presented to NEMMCO a reasonable time in advance of each auction. NEMMCO is only to accept as valid bids those that are no greater than the audited capacity.

NEMMCO is not to disclose the information contained in the audited report to the Settlements Residue Committee, but may disclose that report to the Commission if requested to do so.

C4.3 SHT may request that 12 months after the release of this Determination condition C4.2 is reviewed. The review is to be conducted by NEMMCO.

NEMMCO is to report on:

- (a) the effectiveness of condition C4.2; and
- (b) recommendations for the re-drafting of C4.2 should this be considered appropriate.

4.2.2 Pricing arrangements

The proposed changes to the NEC (clause 3.18.3(b)) allow for a reserve price to be set for each unit of settlements residue to be auctioned. Clause 3.18.3(b) also provides that the auction clearing price for each unit of settlements residue in relation to each directional interconnector will be a common clearing price.

Issues for the Commission

The setting of a reserve price and the use of a common clearing price may constitute conduct which could contravene section 45 of the Act by maintaining, controlling or fixing prices.

What the applicants say

Section 8.9.2 of the Commission's 10 December 1997 Determination stated that the proposal to distribute the settlements residue to end use consumers via TNSPs reducing TUOS charges was the most transparent, equitable and efficient distribution of the IRSR.

NEMMCO has stated that the purpose of the reserve price and common clearing price provisions is to meet the Commission's objective of providing the benefit of the IRSR to end-use consumers by way of reduced TUOS charges and accordingly, ensuring the most efficient possible use of the IRSR.⁵

NEMMCO says that the auctions have been designed to achieve bid prices so that the auction proceeds (and, accordingly, the reduction in TUOS charges) reflect the value of the settlements residue. NEMMCO states that jurisdictions are concerned that the value of the settlements residue is preserved, and that they favour the setting of a reserve price by NEMMCO.

Issues arising from the Draft Determination

After assessing the data relating to auctions held before 11 November 1999, the Commission observed that while the reserve price has acted as a price floor, the market has assessed the value of the IRSR to be greater than that implied by the reserve price. It would therefore follow that if there were no reserve price the auction would have still have produced largely similar results.

Nevertheless, the Commission was of the view that not allowing market customers to bid below a pre-determined bid price risks creating anti-competitive effects that impact upon the efficiency of market outcomes. Therefore, the Draft Determination imposed the following condition of authorisation:

C4.3 Clause 3.18 of the NEC must be amended to state that the setting of reserve prices in relation to auctions of units of inter-regional settlements residue will only apply to residues accumulated on or before 31 December 2001.

What interested parties say

Hazelwood Power expressed concern at the need to set a reserve price. Bardak and United Energy expressed similar concerns. For example, Hazelwood Power's submission stated that unfettered access to the settlement residues should enable inter-regional price exposure to be managed, leading to increasing liquidity in the financial swaps market and a more efficient retail market. Hazelwood Power contends that market participants are able to more accurately estimate the value of the IRSR than consultants and the jurisdictions.

⁵ Section 8.9.2 of the Commission's 10 December 1997 Determination stated that the proposal to distribute the settlements residue to end use consumers via TNSPs reducing TUOS charges was the most transparent, equitable and efficient distribution of the IRSR.

None of the submissions in response to the Draft Determination objected to the Commission's removal of the ability to set a reserve price for settlement residues after 31 December 2001.

However, Bardak Group raised concerns about the level of the reserve price. Specifically, Bardak was concerned that NEMMCO should apply a uniform fraction of the accessed value as the reserve price rather than allow the jurisdictions to set that percentage, and thus the reserve price value.

Commission considerations

Common clearing price

The Commission believes that the calculation of the common clearing price is unable to influence bidding strategies and therefore is unlikely to distort market outcomes.

Reserve price

As discussed in the applicant's submission and the submission of the Department of Treasury and Finance, Electricity Reform and Sales Unit (South Australia), the rationale for setting a reserve price is to maintain the value of the IRSR at auction. The jurisdictions, as representatives of end use customers, wish to ensure that the auction proceeds – which will flow to end use customers via a reduction in TUOS charges – reflect the initial value of settlements residues. In setting a reserve price, the end use customers are guaranteed a minimum benefit, and the opportunity for auction participants to make windfall arbitrage gains is decreased.

The Commission observes that having the reserve prices set as a *varying* fraction⁶ of the independently assessed value of the residue does not, on its own, distort likely market outcomes. Further, there is no evidence that the calculation of the level of the reserve price in this way has distorted market outcomes as auctions have been cleared at prices exceeding the reserve price.

Condition of Authorisation

C4.4 Clause 3.18 of the NEC must be amended to state that the setting of reserve prices in relation to auctions of units of inter-regional settlements residue will only apply to residues accumulated on or before 31 December 2001.

4.2.3 NEMMCO's discretion and rule change processes

The changes to the NEC allow NEMMCO, amongst other things:

⁶ Clause 7 of the Auction Rules (dated 22 June 1999) sets out the proportion of the IRSR valuation which is to form the reserve price. The highest proportion exists in relation to the Victoria to South Australia directional interconnector, where the reserve price is 70% of the estimated value of the settlements residue. The lowest proportion (0%) exists in relation to reserve prices for the South Australia to Victoria and NSW to Snowy directional interconnectors. The reserve price is zero in relation to those interconnectors.

- to suspend or cancel auctions (clause 3.18.2(d) and 3.18.2(e)⁷);
- to choose the valuations which make up the reserve price (clause 3.18.3(b) states that the reserve price may be set, but the discretion of NEMMCO in this regard is set out in the auction rules);
- to set conditions on auction participation (clause 3.18.2); and
- to set the *auction expense fees* payable by all auction bidders (clause 3.18.3(a)(4)).

Clause 3.18.5 establishes a ‘Settlements Residue Committee’ (SRC) made up of representatives for the market participants. This Committee’s functions include approving proposed auction rule changes, auction suspensions and costs and expenses incurred by NEMMCO in conducting auctions (clause 3.18.5(b)). At any time if an amendment is considered ‘urgent’, clause 3.18.4(f) enables NEMMCO to avoid the Code Consultation Procedures by obtaining the agreement of a $\frac{3}{4}$ majority of the SRC in relation to the proposed amendment.

Issues for the Commission

In giving considerable discretion to NEMMCO to define the rules governing the conduct of settlement residue auctions, clause 3.18.3 has the potential to affect the public benefit or anti-competitive detriment of the auction arrangements. In a similar way, the power to amend the rules conferred on NEMMCO with the approval of the SRC in clause 3.18.3(d)–(f) is indicative of wide discretion which can alter the balance of the anti-competitive detriment and public benefits associated with the SRA process.

What the applicants say

NECA has stated that the changes to the NEC seek to ‘ensure that NEMMCO is property and adequately accountable for the way in which it administers the auction process.’

What interested parties say

As part of the consultation process conducted by the Commission, Ergon Energy, Hazelwood Power, and United Energy expressed concerns relating to the discretions that can be exercised by NEMMCO, and the role of the SRC in the exercise of those discretions.

Ergon Energy was concerned that the existence of the SRC is not sufficient oversight for the auction rule change process conducted by NEMMCO. In particular, Ergon

⁷ Code clause 3.18.4(d) provides that NEMMCO can amend the rules at any time with the approval of the SRC. Clause 3.18.5 of the Code changes provides that the SRC is to be made up of a chairman appointed by NEMMCO, and one representative for each of the following participants: a Generator, a Market Customer, Transmission Network Service Providers, Traders, Ministers of participating jurisdictions, and end use customers. In every participation category apart from end use customers, the appointment or removal of the representative is to be agreed by $\frac{1}{3}$ of that class of participant. In the case of end use customers, NECA has the power of appointment (clause 3.18.5(c)(7)) and can remove the representative at any time for any reason (clause 3.18.5(g)).

Energy and Hazelwood Power were concerned at the ability of NEMMCO and the SRC to change the auction rules when viewed as ‘urgent’ where the term ‘urgent’ is not defined, leaving open the possibility of disputes if this broad power is triggered.

When looking at the decision making power of the SRC Ergon Energy also expressed concern that the level of consensus required to obtain the ‘approval’ of the Committee was unclear. This ‘approval’ is required for:

- changes to the auction rules (clause 3.18.3(d));
- the suspension of, or the removal of suspension of an auction (clause 3.18.2.(d));
- the amount of auction expense fees to be levied (clause 3.18.4(c)); and
- clause 3.18.3(f) provides that auction rule changes need not go through the Code Consultation Procedures if three quarters of the SRC agree and NEMMCO considers that the amendment is ‘urgent’ or the amendment is made within three months of the first SRA. The first SRA was conducted during July 1999. Therefore, the ability to make changes to the auction rules which do not conform with the Code Consultation Procedures ceases in October 1999.

The power of NEMMCO to cease conducting auctions after complying with Code Consultation Procedures under clause 3.18.2(d) and (e) is also of concern to Ergon Energy and Hazelwood Power. Hazelwood Power states that the cessation of auctions may, in effect, expose market participants to regulatory risk by removal of an expected vehicle for risk management, and should therefore be avoided.

Clause 3.18.5(e) provides that, apart from the NEMMCO employee acting as chairperson and the end user representative appointed by NECA, one third of the relevant class of Code Participants in each category must agree to the appointment and removal of the committee representative for that category. Ergon Energy point out that it is quite possible that two candidate advanced by opposing sections of a Code Participant class could rally more than one third of the support of that class of Code Participant, rendering that clause ineffective.

In relation to the auction expense fees, Ergon Energy and Hazelwood Power express concern that the level of these fees is unknown.

Issues arising from the Draft Determination

At the pre-determination conference, NEMMCO expressed concern that there may be some ambiguity in the Commission’s conditions of authorisation as set out in the Draft Determination. In particular, the conditions may be interpreted as giving NEMMCO the option to exclude participants from the auction process, rather than requiring exclusion from participation. This raised the possibility that the SRC may be able to determine which parties were able to participate in the auction.

TransGrid stated that it would be opposed to giving NEMMCO or the SRC the power to determine participation in the auction process.

Bardak argues that discretion to appoint an end user representative to the SRC should rest with end user organisations rather than with NECA as is specified in the proposed code changes. Bardak states that in every participation category apart from end use customers, the appointment or removal of the SRC representative is to be agreed by one third of that class of participant. In the case of end use customers, NECA has the power to appoint and remove the representative at any time for any reason. Bardak has put forward a number of options as to how a suitable representative might be nominated by peak end user representative organisations but contend that actual method is a matter for the peak organisations themselves to resolve.

In response to calls from end-user groups to nominate their own representative on the SRC NECA noted that such a position was recently advertised and that no responses to the advertisement were received.

Commission considerations

When considering the amendment of the auction rules, clause 3.18.3(d) provides that the approval of the SRC is a prerequisite. In general, these amendments must be developed utilising the Code Consultation Procedures provided in Chapter 8 of the NEC to take into account the impact on all participants by ensuring that the decision making explicitly takes into account their interests.

The role of the SRC in approving the actions of NEMMCO relating to the suspension or recommencement of the auction process and the charging auction fees represents a new level of scrutiny and accountability in relation to NEMMCO's exercise of its functions.

Interested parties and the Commission considered that the establishment of a SRC is a step forward in ensuring that NEMMCO is properly and adequately held accountable for the way in which it administers the auction process. This is especially reflected in the auction monitoring, review and reporting role the SRC is given in clause 3.18.5 of the Code.

NEMMCO's accountability is enhanced by seeking to ensure that the Committee's industry representatives are genuinely representative of their market sectors, and that all market sectors, including end users, are included. The involvement of the Committee in approving NEMMCO's proposed changes to the auction rules provides for a greater level of accountability to Code Participants and end users than is provided for in relation to NEMMCO's market operations role.

Although greater procedural clarity is desirable, the Commission believes that inclusion of the proposed consultation procedures, involving both the Code Consultation Procedures and the SRC, will reduce the risk of inappropriate use of NEMMCO's discretionary powers, and thus enhance overall public benefits.

The Commission recognises that the creation of a SRC gives an opportunity for consultation and cooperation of market participants in creating auction rules. However, giving the SRC discretionary power to determine exclusions from participation is seen as undesirable by the Commission, and was not intended. This is why condition 4.1

imposed in this final Determination states that ‘the eligibility criteria set out in the auction rules *shall* only exclude the following categories of persons’.

4.2.4 South Australian distribution of the settlements surplus and exclusion of ETSA Power from auction processes

At the pre-determination conference and in submissions following release of the Draft Determination Bardak raised concerns regarding ETAS Power's participation in the settlement residue auction. Due to vesting contracts and a derogation to the NEC, ETSA Power has been allocated a portion of the interconnects capacity to cover franchise load risk. ETSA Power is also free to enter the settlements residue auction process to secure further capacity over the interconnect. Bardak argues that this creates a barrier for inter-state retailers seeking to compete in the South Australian market as it allows ETSA Power to maintain its already dominant market share.

Commission considerations

The South Australian government applied for a derogation in relation to the distribution of settlements surplus relating to the Victorian/South Australian link (this derogation was assessed by the Commission in its Draft Determination of 8 October 1999, given interim authorisation on 8 December 1999; a final Determination on this matter was issued on 22 December 1999).

The derogation sets out that the settlements residue arising from the flows across the interconnector (from Victoria into South Australia) are to be distributed as follows:

- A maximum of 50 percent of the settlements surplus accruing to South Australia will be available to hedge the exposure of retailers (ETSA Power) in the State to fluctuating electricity prices with respect to franchise (non-contestable) customers. The 50 percent figure is based on the maximum percentage of franchise customers to total load in South Australia – the actual percentage will reduce as the ration of franchise to total customers declines; and
- The remainder of the settlements surplus has been handed back to NEMMCO for an auction in support of inter-regional price hedging.

The Commission has accepted this derogation is a transitional measure which will end at 31 December 2002.

Bardak commented on ETSA Power’s ability to participate in the remaining capacity over the interconnect. In addition, Western Mining Corporation advocated that the capacity reserved for franchise customers should include the 50% allocated to ETSA Power. SA Treasury has since confirmed that the vesting contracts take account of this allocation in setting contract volumes. Moreover, the Commission has not received any submission from retailers regarding impediments to trade in South Australia arising from ETSA Power being able to bid for the portion of settlements residue remaining from the derogation. The Commission also understands that other retailers have been successful in bidding for this part of the residue. In fact the Commission believes that there are a number of factors impacting on the lack of effective retail competition in South Australia including the;

- tight demand and supply balance;
- availability of South Australian generators; and
- residual operation of vesting contracts.

Consequently, the Commission does not believe that any restrictions on the ability of ESTA Power to bid for settlements residue will necessarily translate into more effective entry by interstate retailers.

5. Determination

Although the Commission considers that some of the proposed arrangements and conduct set out in the SRA proposals would be likely to lessen competition, it also considers that there is likely to be a significant public benefit resulting from the proposed arrangements and conduct. For the reasons outlined in section 4, the Commission concludes that, subject to the conditions set out below, in all the circumstances the proposed SRA arrangements and conduct:

- are likely to result in a benefit to the public which outweighs the potential detriment from any lessening of competition that would result if the proposed conduct or arrangements were made, or engaged in; and
- are likely to result in such a benefit to the public that the proposed conduct or arrangements should be allowed to take place or be arrived at.

The Commission proposes to grant conditional authorisation to applications A90671, A90672 and A90673 as amended on 24 May 1999, 22 June 1999 and 9 November 1999. This authorisation (apart from the ability to set reserve prices) will expire on 31 December 2002. Authorisation of the setting of reserve prices is to exist only in relation to auctions for the settlements residue up to and including 31 December 2001.

This authorisation is also subject to any application to the Australian Competition Tribunal for its review.

The authorisation that the Commission proposes to grant is subject to the following conditions:

C4.1 Clause 3.18.2 of the NEC must be amended to state that the eligibility criteria set out in the auction rules shall only exclude the following categories of persons:

- (a) persons that have not entered into an auction participation agreement;
or**
- (b) transmission network service providers; or**
- (c) persons registered under the Code as Generators and licensed to generate electricity under the Electricity Act 1996 (South Australia) or exempted from the requirement to obtain such a license, as at 1 January 1999, but only in relation to bidding and purchasing units of settlements residues relating to the Victoria to South Australia directional interconnector; or**
- (d) persons who have defaulted on payment obligations under an auction participation agreement or otherwise under clause 3.15.21 of the NEC;
or**

- (e) any person acting on behalf of or in concert with a person described in paragraphs (a) to (d) above.

C4.2 This condition relates to settlements residue arising from the New South Wales to Snowy directional interconnector and the Victoria to Snowy directional interconnector only. The maximum amount of units that may be acquired by Snowy Hydro Trading Pty Limited (SHT), registered under the Code as a Generator, is to be no greater than the audited need for that settlements residue as demonstrated by existing contracts entered into by SHT. SHT may bid an additional five percent above these audited requirements. The audited report is to:

- (a) be prepared by an independent auditor, taking into account demonstrated pumping needs and contractual exposure to quantify the approximate capacity equivalent of inward-flowing settlements residue required by SHT to hedge its financial risk in each future auction quarter; and**
- (b) be presented to NEMMCO a reasonable time in advance of each auction. NEMMCO is only to accept as valid bids those that are no greater than the audited capacity.**

NEMMCO is not to disclose the information contained in the audited report to the Settlements Residue Committee, but may disclose that report to the Commission if requested to do so.

C4.3 SHT may request that 12 months after the release of this Determination condition C4.2 is reviewed. The review is to be conducted by NEMMCO.

NEMMCO is to report on:

- (a) the effectiveness of condition C4.2; and**
- (b) recommendations for the re-drafting of C4.2 should this be considered appropriate.**

C4.4 Clause 3.18 of the NEC must be amended to state that the setting of reserve prices in relation to auctions of units of inter-regional settlements residue will only apply to residues accumulated on or before 31 December 2001.

Appendix – Submissions

Bardak Energy Services (2 submissions)

Ergon Energy

Department of Treasury and Finance, Electricity Reform and Sales Unit (South Australia)

ETSA Power

Hazelwood Power

Snowy Hydro Trading Pty Limited

TransGrid

United Energy

