

MEMORANDUM

DATE:	22 JULY 2010
TO:	GAS WHOLESale CONSULTATIVE FORUM
FROM:	ELIZABETH O'BRIEN
SUBJECT:	AMENDMENT TO INTEREST RATE RULE CHANGE

1. Executive Summary

- AEMO submitted a proposed Rule change to the AEMC on 31 May 2010 to amend references to calculations of interest for the Declared Wholesale Gas Market back to 'simple interest calculated daily' from 'compounded daily', a change which was introduced in the transition from MSOR to NGR on 1 July 2009. AEMO requested that the Rule change be considered non-controversial because there was no material impact on the market. This issue was raised at the Gas Wholesale Consultative Forum on 22 March 2010.
- Discussions with the AEMC have identified additional issues with the NGR that may be addressed as part of this Rule change, including correction of the definition of interest rate (NGR 203).
- The AEMC have indicated a non-binding preference not to make a more preferable Rule under the non-controversial process.
- As such, AEMO is withdrawing its original Rule change and will re-submit an amended Rule change proposal which deals with the new issues as well as the original ones. AEMO will request that this proposal be considered under the non-controversial process.

2. Background

On 31 May 2010, AEMO submitted a Rule change proposal to the AEMC requesting an amendment to the National Gas Rules (NGR) regarding the methodology used for interest rate calculations in the Declared Wholesale Gas Market (DWGM).

The proposed amendments for the DWGM would correct an unintended change that was made in transitioning the Market and System Operations Rules (MSOR) to the NGR on 1 July 2009 and realign the NGR with current market systems.

The proposed Rule sought amend clauses 238(4), 238(6), 249(4)(b) and 253(2) of the National Gas Rules (NGR) to allow AEMO to continue calculating interest on compensation payments, adjustments to revised statements, and overdue amounts, using a simple interest methodology rather than requiring costly changes to market systems to enable these amounts to be compounded daily for the DWGM.

The original Rule change proposal was discussed at the Gas Wholesale Consultative Forum in meeting number 156 held on 22 March 2010¹.

¹ http://aemogas.com.au/index.php?action=filemanager&folder_id=1669

3. Issue

Discussion with the AEMC has uncovered several other inaccuracies in the NGR. In particular, the definition of the interest rate (NGR 203) used in the DWGM requires amendment.

The current definition is:

1. A reference in this part to the interest rate is a reference to the Bloomberg Bank Bill Swap Reference Rate most recently published in the Australian Financial Review
2. If the above rate ceases to exist, or that rate becomes, in AEMO's reasonable opinion, inappropriate, the interest rate is a rate determined and published by AEMO

The Australian Financial Review does not publish the Bloomberg rate, but publishes the Reuters rate. Hence, AEMO has been using a 90-day Bank Bill Swap Rate which is calculated daily by the Australian Financial Markets Association (AFMA). AFMA data is available via Thomson Reuters, Bloomberg and CQG.²

4. Proposed change

The AEMC has indicated a preference to deal with the additional issues identified in the one Rule change. However, they have indicated a preference to not to make such additional amendments as part of a non-controversial Rule. As such, AEMO will withdraw the original Rule change proposal and re-submit a new Rule change which deals with the original issues as well as the definition for interest rates. The new Rule change proposal will also be put forward as non-controversial since none of the changes have a material impact on any of the gas markets.

A summary of all the proposed changes which related to the DWGM is contained in Attachment A.

The amendment to the definition of the interest rate for the DWGM (which was not included in the original Rule change proposal) is explained in this memorandum.

The draft new proposed definition for interest rate at this stage is:

1. A reference in this part to the interest rate is a reference to the Bloomberg 30-day Bank Bill Swap Reference Rate most recently published by the Australian Financial Markets Association in the Australian Financial Review
2. If the above rate ceases to exist, or that rate becomes, in AEMO's reasonable opinion, inappropriate, the interest rate is a rate determined and published by AEMO

Note that the *default interest rate* is defined as "a rate of 2% above the interest rate" and this definition will not be amended as part of the proposal.

AEMO currently uses 90-day Bank Bill Swap (BBSW) rates as determined by the Australian Financial Market Association.

In order to determine the rate to be applied to interest payments, AEMO uses an averaging methodology which takes the rate each day over the time period for which interest is to be calculated and averages them.

As part of the change of the definition, it is proposed to insert a tenor for the BBSW rate to be used. The proposed rate to be used is a 30-day BBSW rate as determined by the AFMA. Reasons behind these changes are outlined in the following section.

² Australian Financial Markets Association, <http://www.afma.com.au/>

5. Logic behind change

The reasons supporting the change to the definition are as follows:

- The Australian Financial Markets Association is the original source of BBSW data for Australia. Both Bloomberg and Reuters publish data sourced from AFMA.
- The Australian Financial Review publishes day +1 data on interest rates, where as AFMA publishes data at around 10 am on the actual day. Using the most up-to-date data allows interest calculations to be more accurate.

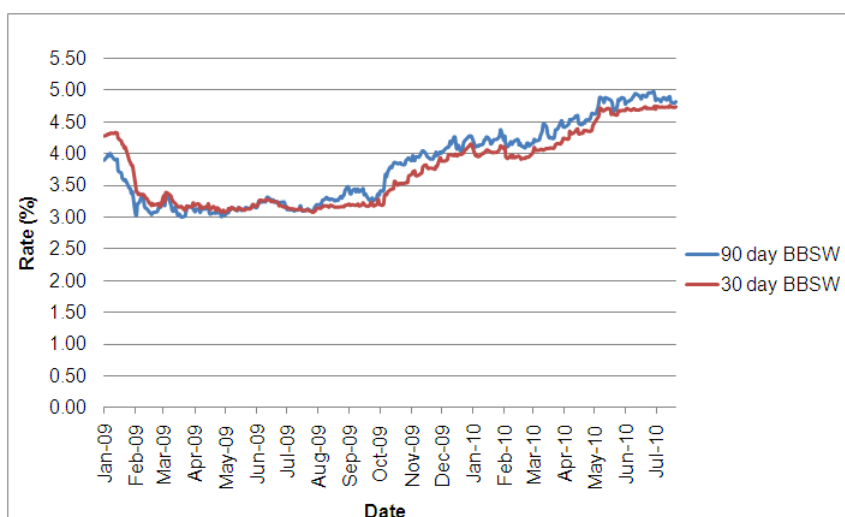
Reasons for the change from 90-day BBSW to 30-day BBSW and inclusion in the definition:

- Including a tenor (e.g. 30-day, 90-day) in the definition will clarify and give certainty that of the interest rate that will be used. In the circumstance where the rate no longer exists it gives guidance as the rate that AEMO would adopt.
- 30-day BBSW is consistent with the rate used for the National Electricity Market (NER Chapter 10). Adopting a rate with a 30-day tenor for the DWGM (as well as the STTM and Bulletin Board – see additional amendments section on page 4) would enable consistency across energy markets.
- The 30-day BBSW tends to have less speculation, hence less volatility than those rates of a larger tenor (see Figure 1 on page 3).
- When determining the rate to be used, AEMO takes an average of the daily rates over the time period that the interest is to be calculated. Using the interest rate with the same tenor as the time period over which interest is to be calculated is applicable if the interest rate from a particular day is used. Given that AEMO uses an averaging methodology it is not necessarily appropriate to use a rate that is the same tenor as the time period for which interest is to be calculated.

6. Materiality of additional changes

Where the interest rate curve is ‘normal’, that is, upwards sloping over time - reflecting the expectation of interest rates rising in the future, the 30-day BBSW rate is less than the 90-day BBSW rate. Conversely, when the interest rate curve is ‘inverted’ - reflecting the expectations that interest rates will fall in the future, the 30-day BBSW rate will return a higher amount than the 90-day BBSW rate. Figure 1 shows the historical difference between the two rates.

Figure 1: Historical 90-day BBSW and 30-day BBSW rates



Regardless of the position of the interest rate curve, the impact to the market and individual market participants of changing the reference rate from a 90-day to a 30-day tenor is likely to be very small.

Interest calculations are used most commonly for the purposes of adjustments to the Final Statements included in the Revision Statements issued. Adjustments to Final statements vary from month to month. The following tables provide data on the six most recent Revised Statements completed for the DWGM which may be used to determine the impact of the change.

Table 1: Average Final Statements, percentage adjustments to statements for Revisions Statements, interest paid

Month	Payments from Participants to the Market Total Adjustments to Final Statement for Revisions Statements	Payments from the Market to Participants Total Adjustment to Final Statement for Revision Statements
July 2009	\$198,795.70	-\$198,883.59
August 2009	\$217,607.29	-\$217,717.15
September 2009	\$206,453.09	-\$206,430.56
October 2009	\$138,549.18	-\$138,605.34
November 2009	\$123,667.57	-\$109,036.42
December 2009	\$74,287.75	-\$74,534.38
Average revision adjustment	\$159,893.43	-\$157,534.57

Table 2: Interest rate and interest included in Revised Statements

Month	Interest rate used (90-day BBSW)	Interest on adjustments for Revised Statements - payments from Participants to the Market	Interest on adjustments for Revised Statements - payments from the Market to Participants
July 2009	3.93%	\$3,895.14	-\$3,897.36
August 2009	4.08%	\$4,426.95	-\$4,429.26
September 2009	4.17%	\$4,409.76	-\$4,410.21
October 2009	4.31%	\$2,928.33	-\$2,929.66
November 2009	4.31%	\$2,707.81	-\$2,387.45
December 2009	4.44%	\$1,660.70	-\$1,666.24
Average	4.26%	\$3,338.12	-\$3,286.70

A more detailed explanation of the change and estimates of the impact will be included in the new Rule change proposal.

7. Additional Amendments for Proposal for STTM and Bulletin Board

In addition to the amendments to the Part 10 Declared Wholesale Gas Market section of the NGR, AEMO and the AEMC have also identified several issues with Part 20 – Short Term Trading Market and Part 18 - Natural Gas Service Bulletin Board sections.

These issues will also be addressed as part of the new Rule change proposal. The changes for these sections are summarised as in Attachment B.

The rule change proposal will align the definitions for *interest rate* in the DWGM and the STTM, and the definition for *applicable interest rate* in the Bulletin Board. The proposal seeks to align all three definitions. As such, the proposal will also seek to change references to *applicable interest rate* for the Bulletin Board to *interest rate*. The definition for interest rate can then be removed from Parts 18, 19, and 20 and inserted into the general definitions section of the NGR (section 7).

8. Next steps

AEMO will draft the new Rule change proposal and submit this to the AEMC in the next month. AEMO will be requesting that the Rule change proposal be considered non-controversial and therefore be assessed in a six-week period from when the AEMC announces the Rule change.

Elizabeth O'Brien
Regulatory Analyst

Attachment A: Summary of changes for DWGM

Circumstance	Market and System Operations Rules (v31)		National Gas Rules (v2)		Draft Proposed Rule change
	Clause	Relevant extracts	Clause	Relevant extracts	
Compensation amounts	3.6.6(f)	Interest is to be calculated on a daily basis and aggregated for the period.	238(4)	Interest is to be compounded daily.	Interest is to be calculated on a simple interest basis.
	3.6.6(k)	Interest is to be calculated on a daily basis and aggregated for the period.	238(6)	Interest is to be compounded daily.	Interest is to be calculated on a simple interest basis.
Adjustments to final statements for revised statements	3.6.19 (d)(2)	...interest calculated on a daily basis at the interest rate for the period...	249 (4)(b)	...interest (compounded daily) at the interest rate for the period	Interest is to be calculated on a simple interest basis.
Overdue amounts	3.6.23(b)	...the default interest rate calculated as simple interest on a daily basis ... with interest compounding on monthly rates on the last day of each month....	253(2)	...the interest accrues at the default interest rate, compounding daily...	[Interest is to be] calculated as simple interest on a daily basis ... with interest compounding monthly on the last day of each month while the unpaid moneys remain outstanding.

	National Gas Rules (v2)		Draft Proposed Definition	Rate currently used	Proposed Rate to be used
	Reference	Definition			
Interest rate	NGR 203	<p>(1) A reference in this Part to the interest rate is a reference to the Bloomberg Bank Bill Swap Reference Rate most recently published in the Australian Financial Review.</p> <p>(2) If the above rate ceases to exist, or that rate becomes, in AEMO's reasonable opinion, inappropriate, the interest rate is a rate determined and published by AEMO.</p>	<p>(1) A reference in this Part to the interest rate is a reference to the 30 day Bank Bill Swap Reference Rate published by the Australian Financial Markets Association.</p> <p>(2) If the above rate ceases to exist, or that rate becomes, in AEMO's reasonable opinion, inappropriate, the interest rate is a rate determined and published by AEMO.</p>	90 day Bank Bill Swap Rate sourced from Australian Financial Markets Association	30 day Bank Bill Swap Reference Rate that is calculated by the Australian Financial Markets Association

Attachment B: Amendments for STTM and Bulletin Board

	Circumstance	National Gas Rules		Draft Proposed Rule	Notes
		Clause	Relevant extracts		
Short Term Trading Market	Revised Statements	473(5)(b)	...plus interest calculated on a daily basis at the interest rate...	...plus interest calculated on a daily basis at the interest rate... Interest is to be calculated on a simple interest basis.	Revised statements will be issued on the 5th business day at the end of the 9th billing period after the relevant billing period. Interest would be calculated over this approximate 9 month period.
	Determination of Payment claims	466(4)	Interest is payable on amounts ... calculated on a daily basis at the interest rate ...	Interest is payable on amounts ... calculated on a daily basis at the interest rate... Interest is to be calculated as simple interest on a daily basis ... with interest compounding monthly on the last day of each month while the unpaid moneys remain outstanding.	The Rules for calculation of compensation claims for the STTM were originally calculated as simple interest. However, it is proposed that this should be changed to simple interest compounding monthly to be consistent with the DWGM and the NEM methodologies of compensation claims.
	Overdue amounts	476(2)	calculated on a daily basis at the default interest rate	calculated as simple interest on a daily basis at the default interest rate	
Natural Gas Service Bulletin Board	Payment of invoices – error where Shipper has been over charged	194(3)(a)	... with interest... calculated at the applicable interest rate, accruing on a daily basis...	... with interest... calculated at the applicable interest rate, calculated as simple interest on a daily basis...	There have been no errors in invoices to Shippers for the Bulletin Board service so interest calculations have never acted. Although it is generally accepted that “accruing on a daily basis” may imply daily compounding, AEMO considers that interest for this market should be calculated using simple interest. This would be consistent with all other uses of interest rates in other markets operated by AEMO.
	Payment of invoices – error where Shipper has been under charged	194(4)	...interest... at the interest rate which is 2% per annum above the applicable interest rate, accruing on a daily basis...	...interest... at the interest rate which is 2% per annum above the applicable interest rate, calculated as simple interest on a daily basis...	The difference between compounding and simple interest is insignificant since the total cost of the Bulletin Board for each financial year is approximately \$200,000.
	Disputed tax invoices	195(3)	...together with interest...at the applicable interest rate, accruing on a daily basis...	...together with interest...at the applicable interest rate, calculated as simple interest on a daily basis...	

	Rate	National Gas Rules (v2)		Draft Proposed Definition	Rate currently used	Proposed Rate to be used
		Reference	Definition			
Short Term Trading Market	Interest rate	NGR 2364	<p>(a) the Bloomberg Bank Bill Swap Reference Rate identified by AEMO on its website for the purposes of this Part, as most recently published in the Australian Financial Review; or</p> <p>(b) if no such rate is published or, in AEMO's reasonable opinion, appropriate, a replacement rate determined and published by AEMO.</p>	<p>(1) A reference in this Part to the interest rate is a reference to the 30 day Bank Bill Swap Reference Rate published by the Australian Financial Markets Association.</p> <p>(2) If the above rate ceases to exist, or that rate becomes, in AEMO's reasonable opinion, inappropriate, the interest rate is a rate determined and published by AEMO.</p>	90 day Bank Bill Swap Rate sourced from Australian Financial Markets Association	30 day Bank Bill Swap Reference Rate that is calculated by the Australian Financial Markets Association
Natural Gas Service Bulletin Board	Applicable interest rate	NGR 141	the interest rate quoted from time to time by Australia and New Zealand Banking Group Limited as its reference rate or, should there cease to be such a reference rate, the rate which that bank designates as being an appropriate substitute for the reference rate.	<p>(1) A reference in this Part to the interest rate is a reference to the 30 day Bank Bill Swap Reference Rate published by the Australian Financial Markets Association.</p> <p>(2) If the above rate ceases to exist, or that rate becomes, in AEMO's reasonable opinion, inappropriate, the interest rate is a rate determined and published by AEMO.</p>		30 day Bank Bill Swap Reference Rate that is calculated by the Australian Financial Markets Association