



Energy Retailers Association
of Australia Limited

30 April 2010

The Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South
NSW 1235

Re: EMO0008 – Review into the role of hedging contracts in the existing NEM prudential framework – Draft Report

Dear Dr Tamblyn

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to comment on the Australian Energy Market Commission's (the Commission's) review into the role of hedging contracts in the existing NEM prudential framework.

The ERAA is the peak body representing the core of Australia's energy retail organisations. Membership is comprised of businesses operating throughout the NEM, Western Australia and the Northern Territory. These businesses collectively provide electricity to over 98% of customers in the NEM and are the first point of contact for end use customers for both electricity and gas.

General Comments

The ERAA welcomes the Commission's review and supports the recommendations to continue with Reallocation Arrangements (RAs). It also supports the inclusion of Futures Offset Arrangements (FOAs) in the NEM prudential offset arrangements, subject to them not adversely affecting the credit worthiness of the NEM. The ERAA also endorses AEMO investigating alternative maximum credit limit (MCL) methodologies.

The ERAA is concerned, however, that the review surpasses that of just a review of the *role* of hedging contracts because it makes recommendations on the technical and legal aspects of how these prudential offset arrangements be included in the NEM. The ERAA would like to predominantly reserve comments on the technical details to later stages such as the drafting of the rules process.

3.3 – Considerations specific to RAs

The ERAA supports the conclusion that RAs be continued as a prudential offset arrangement. RAs serve an important role in reducing the required level of credit support for retailers. The ERAA acknowledges the Commission's observation that uptake of RAs has been low. Nonetheless, RAs

help to reduce the barriers to entry for retailers and therefore lead to the overall competitiveness of the NEM, which is key to promoting the National Electricity Objective (NEO).

3.2.2 – Contractual basis for offset arrangements

The ERAA does not support the Commission's recommendation that offset arrangements may only be registered where an underlying contract exists for an offset arrangement. Contracts are not currently required between parties that engage in offset arrangement agreements like ex post dollar reallocations and some ex ante energy reallocations, like those between different entities within the same business group. The Commission has not demonstrated why contracts for these types of reallocations, in particular, are necessary. Until such a case is set out, the ERAA does not support this recommendation or the proposal to apply new civil penalty provisions.

3.2.3 – Volume of energy under offset arrangements

The ERAA is concerned about the recommendation to cap the reduction to the MCL to the average load and would like to see the proposed costs and benefits in greater detail prior to formally commenting on this recommendation.

3.4 – Considerations specific to FOAs

In general, the ERAA supports the recommendations of the Commission to include FOAs. Incorporating FOAs into prudential arrangements is a useful alternative for retailers to decrease their prudential burden. This can ultimately lower the barriers to entry for new retailers and improve the competitiveness of the energy retail market.

The ERAA does however recognise that there is the potential that including FOAs could create credit risks and that this could threaten the overall financial integrity of the NEM. It is important therefore that the mechanism by which FOAs are included in prudential offset arrangements is robust and correct.

4.0 – Draft recommendations on MCL methodology

As noted in a previous submission, the ERAA believes that there are to be benefits in moving to a more forward looking approach that incorporates a futures price in the MCL methodology.¹ That being said, the ERAA agrees that AEMO is the most suitable party to review the MCL methodology and make recommendations on any improvements to the prudential regime more generally. It is important that the AEMC's recommendation on this issue does not constrain AEMO's scope unintentionally. The ERAA therefore cautions the AEMC in making 'off-hand' recommendations, such as the appropriate prudential margin level for the reasonable worst case scenario identified

¹ ERAA submission on PwC draft report, 5 November 2009.

in the draft report. It should be sufficient for the recommendation to identify AEMO as the relevant party to undertake further work.

The ERAA would welcome further discussion on this submission if required. Should you have any queries, please feel free to contact me on (02) 9241 6556.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Cameron O'Reilly', with a large, stylized flourish at the end.

Cameron O'Reilly
Executive Director
Energy Retailers Association of Australia