



9 August 2016

Leah Ross
Senior Director
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

AEMC Reference: ERC0188

Dear Ms Ross

RE: Application of Offsets in the Prudential Margin Calculation, Draft Rule Determination

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) Draft Rule Determination Paper on the application of offsets in the prudential margin calculation rule change request proposed by the Australian Energy Market Operator (AEMO).

About ERM Power Limited

ERM Power is an Australian energy company that operates electricity generation and electricity sales businesses. Trading as ERM Business Energy and founded in 1980, we have grown to become the fourth largest electricity retailer in Australia, with operations in every state and the Australian Capital Territory. We are also licensed to sell electricity in several markets in the United States. We have equity interests in 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland, both of which we operate.

ERM Power supports the proposed draft rule

ERM Power welcomes the Commission's proposed draft rule which amends the National Electricity Rules (NER) to remove the prohibition on offsetting of trading and reallocation amounts in the prudential margin calculation. We strongly support the amendment allowing AEMO to offset between trading and reallocation amounts when determining a market participant's prudential margin and therefore provide credit support relief by lowering the participant's Maximum Credit Limit (MCL).

ERM Power believes there is a strong case for adoption of the draft rule, particularly as it removes the competitive advantage currently held by vertically-integrated market participants and allows a more level basis for competition, with stand-alone market participants also extended the opportunity to use their hedging position to minimise their prudential margin. Further, we agree the rule allows collateral to be used more efficiently, easing the barriers to entry for prospective participants while still maintaining the prudential standard. Ultimately the improvements to capital efficiency and the strengthening of competition are likely to benefit consumers and place participants in a better position to invest in future energy solutions.

Firmness of reallocation amounts

While we believe that there are adequate processes available to AEMO to determine the firmness of reallocations and manage the associated risk, we have considered the scenarios highlighted in the Draft Determination, presented as delivering additional risk. We understand this perceived additional risk is derived from a reduction or removal of a reallocation's offset capability. If a participant's MCL increases during the reaction period without the provision of additional credit support, AEMO is presented with insufficient time to suspend the market participant. The scenarios which could give rise to this risk are:

- a reduction in generation output; or
- the dissolution of a reallocation request (expiry or deregistration contemplated).

The Draft Determination presents four options as potential strategies by which AEMO may mitigate these additional risks¹. Though we recognise these options are likely to be considered for consultation under a relevant AEMO procedure amendment, anticipated through the proposed transitional Rules by 1 July 2017, ERM Power submits that option 2 is our preferred option.

Option 2 allows for full offset, enabling participants to maximise the efficiency gains of the reallocation (unlike partial reallocation under option 4 which may limit efficiency gains). Option 2 contemplates the enforcement of a regime for participants to supply additional credit support within 24 hours to avoid default. This option appears to be practicable in alleviating the identified risk and maintains the opportunities for shorter qualifying ex ante reallocations. Though we see option 3 as feasible in providing participants a longer period to meet credit support should reallocations become non-firm, we consider it to be inferior to option 2. Option 3 has an earlier reallocation lodgement at 14 business days and this requirement may diminish the choice of reallocation products available and flexibility to participants for using reallocations as a risk management tool.

Closing Comments

ERM Power agrees with the Commission that the draft rule will improve competitive neutrality between standalone and vertically-integrated market participants and will lead to a more efficient use of participants' capital. Benefits from a more competitive environment and cost reductions will ultimately be in the interests of consumers.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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¹ AEMC 2016, Application of Offsets in the Prudential Margin Calculation, Draft Rule Determination, 30 June 2016, Sydney p. 21