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The Chairman
Australian Energy Market Commission
Level 16, 1 Margaret Street
SYDNEY NSW 2000

By email: submissions@aemc.gov.au

Dear Dr Tamblyn,

Futures Offset Arrangement Rule change Forum

The National Generators Forum (NGF) was pleased to participate in the Futures Offset Arrangement (FOA) Rule change forum held by the Australian Energy Market Commission (AEMC) on the 30th September 2008.

At the end of the Forum, the AEMC invited further submissions aimed at clarifying issues raised during debate. We are pleased to offer the comments below to confirm the key points we raised at the Forum.

1. Deloitte comparative analysis

The Deloitte analysis presented at the Forum compared the Rules as they were prior to the "reallocation" rule change of 2007 with the proposed Rules. As we noted at the Forum, the Commission will need to compare the existing Rules (inclusive of the reallocation change of 2007) with the proposal. On this basis we urge a cautious interpretation of use of the Deloitte work, as in our view many of the benefits it identifies are already available in the current version of the NER (which includes the "Reallocator" participant category).

Until NEMMCO procedures are in place to allow the Reallocator category to be tested, it appears premature to implement further rule changes aimed at allowing clearing member participation.

2. Risk identification survey

The NGF would be pleased to facilitate a meeting between Deloitte and some private sector generators to ensure that the concerns of these parties - who are arguably most keenly aware of credit risk exposure to the NEM - are fully identified and taken into account.

3. Withdrawal of FOA without placement of an alternate security

This is a major risk which was not clearly identified in the draft Deloitte review (despite having been raised in our earlier submission). If it is possible for a clearing member to revoke a reallocation without replacement security having been lodged, it would be logical that in all circumstances when a client retailer became financially overstretched – the clearer would be expected to cancel the reallocation and transfer the default risk to NEM generators. Clearly such an outcome would undermine the intent of the entire prudential regime. As such, the NGF considers that unless this loophole is removed from the proposal, its acceptance would not further the National Electricity Objective, and therefore it should not proceed.

There was some discussion at the Forum indicating that a similar flaw exists for the current reallocation regime. However discussions with NEMMCO since then have confirmed that it is not possible to revoke an ex-ante reallocation and the only way to reverse such a commitment is for the reallocating parties to submit an equal and opposite reallocation. This approach provides scope for NEMMCO to ensure the retailer has sufficient replacement security in place prior to accepting the reversing transaction.

Importantly these existing Rules differ from what is proposed in section 9 of the proposed Rule – which appears to allow the clearer to exit when its client defaults, without any alternative security being placed.

4. Reasonable worst case methodology for MCL estimate to be maintained

The NGF strongly supports the principle of basing the Maximum Credit Limit on a reasonable worst case scenario, and strongly urges that any variation in the MCL methodology should support the ongoing implementation of this principle. The proponents and NEMMCO indicated this would occur under the proposed Rule change – however the principle is so fundamental to the NEM investment environment that we have taken the opportunity to reiterate it here.

5. Ability for NEMMCO to recover funds from a Reallocator vs Contractual counterparty

Proponents of the Rule change proposal indicated that Clearers have indicated that they are not prepared to become registered under the Rules as Reallocators, but would consider entering into contract based Futures Offset Arrangements. The NGF supports a careful legal review of the differences between these two approaches to confirm that they are equally legally robust from the point of view of NEMMCO recovering funds in the event of a retailer default.

In any event – even if there is no risk differential between the approaches - a clear case needs to be made that the benefits of moving to a contractual approach, rather than the Rules based approach, outweigh the costs of change.

6. Strong support for detailed legal review

We support the need for a thorough legal review of the other matters identified by Deloitte to ensure NEM prudential integrity is ensured.

Overall, the NGF is supportive of the AEMC approach to this review, and in particular its decision to seek expert advice on the implications of these detailed prudential matters. We appreciate the opportunity to participate in the debate afforded by the recent Forum.

Our core principle on NEM prudential matters remains that the credit quality of the NEM pool must be maintained. This will ensure ongoing investor confidence in the NEM and therefore go to the heart of the NEM objective by supporting the generation investment required to deliver secure affordable energy to electricity consumers.

We would be pleased to participate in any future discussion in relation to planned legal review of the FOA rule change should that be undertaken by the AEMC. In addition, should you require further information on this submission, please contact the undersigned on 02 6243 5120.

Yours sincerely

A handwritten signature in blue ink that reads "John Boshier". The signature is written in a cursive style with a large, looping initial "J".

John Boshier
Executive Director