8 February 2016

Mr John Pierce
Chairman
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

Lodged via www.aemc.gov.au

Dear Mr Pierce

RE: Application of Offsets in the Prudential Margin Calculation (Ref ERC0188)

GDF SUEZ Australian Energy (GDFSAE) appreciates the opportunity to comment on the Australian Energy Market Commission (AEMC) Application of Offsets in the Prudential Margin Calculation Consultation Paper (Consultation Paper).

The Consultation Paper describes a change proposed by the Australian Energy Market Operator (AEMO) to the National Electricity Rules (NER) which relates to the treatment of reallocation arrangements in the prudential margin calculation.

The role of the prudential framework is to minimise the probability of losses in the NEM in the event of a default of a market participant. Market participants must provide AEMO with an unconditional guarantee for an amount that is greater than or equal to the participants maximum credit limit.

The prudential standard is based on a Probability of Loss Given Default of 2%, which implies that the prudential arrangements will prevent any shortfall of monies collected by AEMO in 98 out of 100 instances of a participant defaulting.

The prudential standard is used by AEMO to calculate the maximum credit limit for every market participant in the NEM using the following formula:

maximum credit limit = prudential margin + outstandings limit

Reallocation arrangements between market participants can be taken into account by AEMO to reduce each of the two market participant's settlement amounts. Prospective reallocations can also provide credit support relief by reducing a participant's outstanding limit and prudential margin. NER clause 3.3.8(e) imposes restrictions however on which reallocation amounts can be used for offsetting of the prudential margin calculation.

GDF SUEZ Australian Energy
Level 33, Rialto South Tower, 525 Collins Street
Melbourne, Victoria 3000, Australia
Tel. +61 3 9617 8400 Fax +61 3 9617 8401
www.gdfsuezau.com
INTERNATIONAL POWER (AUSTRALIA) PTY LTD
ABN 59 092 560 793

The NER change proposal would remove NER clause 3.3.8(e) which restricts offsetting of trading and reallocation amounts in the prudential margin calculation. The effect of this change would be that it would allow AEMO to offset a participant's trading amounts and reallocation amounts when determining the prudential margin for that participant, and therefore reduce both the participant's outstanding limit and prudential margin.

GDFSAE agrees that the restriction imposed by clause 3.3.8(e) no longer has any clear reasoning, and should therefore be removed from the NER. The removal of this restriction would reduce the guarantee amount that participants would need to provide to AEMO. Reducing the financial burden on participants in this manner will lead to an overall improvement in market efficiency.

The Consultation Paper asks for comment on the trade-off between flexibility and regulatory certainty, and in particular whether the NER should make clear that AEMO's methodology to determine prudential settings must provide for prospective reallocations to be offset against trading amounts.

GDFSAE is of the view the regulatory certainty is important in establishing the prudential framework for the NEM, and therefore the NER should include a requirement for the AEMO methodology to provide for prospective reallocations to be offset against trading amounts in the prudential margin calculation.

Leaving this requirement out of the NER would leave to AEMO's discretion, the extent to which it takes account of reallocations in the calculation of a participants prudential margin, which would result in regulatory uncertainty for participants, and less efficient outcomes.

GDFSAE trusts that the comments provided in this response are of assistance to the AEMC in its deliberations. Should you wish to discuss any aspects of this submission, please do not hesitate to contact me on, telephone, 03 9617 8331.

Yours sincerely,

C Deague.

Chris Deague
Wholesale Regulations Manager