



Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

04 November 2009

Submission on PWC's draft risk assessment report regarding MCL and FOA

Dear Dr Tamblyn,

d-cyphaTrade welcomes the opportunity to comment on the PWC Draft Risk Assessment Report regarding the MCL and implementation of FOAs ("the Report"). In our opinion, the Report is an objective and comprehensive summary of the current MCL methodology and Reallocation mechanism as well as the proposed MCL methodology and FOAs. Therefore, d-cyphaTrade will limit comment to two issues that were highlighted by the report, but which will be significantly addressed if the new MCL methodology and FOA arrangements suggested by PWC are implemented.

1. In relation to Maximum Credit Limits, under 2.1 of the Report on page 8, PWC says that "[f]or vertically integrated companies with both generation and retail operations, a net MCL is calculated based on the expected generation into, and consumption from, the NEM in each region and then summed and an interregional adjustment factor applied."

This inbuilt MCL concession for vertically integrated retailers seems to automatically create the effect of reallocation without the reallocation being officially registered with AEMO and without being subject to the normal prudential safeguards. This creates a significant competitive advantage for vertically integrated retailers over independent retailers without generation assets. Unlike registered reallocations, this MCL concession takes into account expected average (aggregated) generation during the MCL period rather than insisting on precisely matching a specific half hour of generation volume to the same specific half hour of demand volume. This creates obvious and extreme risks to the NEM prudential framework.

Furthermore, it seems to automatically provide interregional offsets (albeit with an adjustment factor) exclusively to vertically integrated retailers where their expected generation in one region is allowed to offset their demand in another region. Proposed FOAs would not allow interregional MCL offsets and nor do registered reallocations, due to obvious and insurmountable transmission reliability risks as well as interregional price separation. The existing MCL methodology allows vertically integrated retailers to automatically circumvent these prudential safeguards.

Therefore, d-cyphaTrade believes that the existing MCL calculation competitively disadvantages independent (non-vertically integrated) market participants and also contravenes the spirit of the rules and safeguards



regarding registered reallocations. The introduction of FOAs would address this competition issue by providing fairer access to MCL offsets to independent retailers.

2. With respect to FOAs d-cyphaTrade wishes to highlight a crucial efficiency (competition) benefit that was raised in the PWC report. Currently, an independent retailer can only (practically) approach a small number of base load generators in each region for a reallocation swap to reduce their MCL costs. This provides a few base load generators in each region with significant market power vis a vis the pricing of a reallocation OTC swap. FOAs would introduce competitive pressure into this commercial environment. Therefore, the introduction of FOAs would result in a much more efficient use of MCL offset arrangements and thus contribute greatly to the NEM objective of achieving an efficient market.

d-cyphaTrade would like to thank the Commission for providing us with the opportunity to be actively involved in this very important Market Review. Since the FOA and MCL rule change was first proposed, the Global Financial Crisis ("GFC") has blatantly highlighted the risk of over-reliance on bank credit support (e.g. MCL bank guarantees) and the systemic default risk created by OTC markets operating without clearing house support (e.g. the OTC reallocations market).

Should you have any further questions please do not hesitate to contact us.

Yours Sincerely,

Dean Price.
General Manager.