AUSTRALIAN ENERGY COUNCIL

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Australian Energy Market Operator

Submitted via email to: prudentials@aemo.com.au

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Credit Limit Procedures: Application of Offsets in the Prudential Margin

The Australian Energy Council (the Energy Council) welcomes the opportunity to make a submission to the Australian Energy Market Operator's (AEMO) consultation on the proposed amendments to the Credit Limit Procedures: Application of Offsets in the Prudential Margin (procedure change proposal).

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over 10 million homes and businesses.

The AEMO's procedure change proposal includes the introduction of a mechanism to allow the offset of reallocation amounts against trading amounts in the prudential margin calculation, pursuant to the *National Electricity Amendment (Application of Offsets in the Prudential Margin) Rule 2016* ("**rule change**").

The Energy Council considers that AEMO is taking a sensible approach to enacting the rule change in the Credit Limit Procedures in that it is allowing participants to choose either:

- the *status quo* approach to the prudential margin calculation (renamed the "PM limited offset" option); or
- the full offset option, in which the prudential margin calculation would include offsets between positive trading and positive reallocation amounts. If a participant opts in to this new option, that participant must be able to meet an extended reallocation timetable requirement (14 days ahead).

The Energy Council supports retaining this optionality provided there are not significant and ongoing implementation costs associated with doing so. This approach ensures that participants are no worse off, while providing the ability to opt in to receive the additional benefits from the rule change, provided that participants can meet the 14 day reallocation requirement.

AEMO has taken the opportunity to consult on a number of additional amendments to correct or clarify other aspects of the Credit Limit Procedures including but not limited to, reviewing and updating the process for the estimation of generation amounts. Specifically, AEMO has suggested that, where a generator exhibits significant differences in generation amounts between two or more 35 day periods in the previous 12 months (and no outage has occurred), the assessment of expected generation be based on the lowest average generation in an outstandings period over the past 12 months.

The Energy Council notes that prudential considerations have a significant impact on the operation of participants in the National Electricity Market ("**NEM**") and, as such, the Energy Council endorses efforts to improve the clarity and operation of the existing framework. The Energy Council notes that the methodology for estimating generation amounts can have a significant impact on a participant's maximum credit limit and that an appropriate balance needs to be struck between adequately protecting the market and taking into account the commercial realities of how generators run in the NEM.

The Energy Council is concerned that AEMO's proposal for estimating generation amounts seems overly conservative, too simplistic, and will ignore the commercial realities of how generators operate in the market.

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The Energy Council notes that the NEM is designed to incentivise commercial behaviour, and on face value this proposal does not seem to be cognisant of this. A generator, behaving rationally, would be expected to dispatch generation in the summer if prices were high. During the winter it is possible there will be periods when a generating unit will not be dispatched at all. This is the economic behaviour for this time when prices will generally be low. As such, under the proposal, there is the possibility that a 0MW winter generation level could be ascribed to summer.

Putting this another way, the proposal could potentially result in no benefit being ascribed to peaking and intermediate generators, even though if prices were high they would be economically incentivised to be dispatched and moreover their dispatch would be required in order to ensure system security. The proposal is arguably contrary to the economic incentives that the NEM is designed to create.

While there is benefit in providing specific detail in the Credit Limit Procedures around how estimated generation levels are to be calculated, the Energy Council believes that these seasonal dependencies mean that the proposal does not represent a balanced solution. Our members suggest that AEMO should consider whether there is an alternative solution that better addresses how daily generation amounts should be estimated. The Energy Council would be happy to engage further with AEMO on this.

Any questions about our submission should be addressed to the writer by e-mail to kieran.donoghue@energycouncil.com.au, or by telephone on (03) 9205 3116.

Yours sincerely,

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