29 March 2017

Mr Deep Juneja
Principal Prudentials Analyst, Markets
Australian Energy Market Operator

By email: prudentials@aemo.com.au

Dear Mr Juneja

RE: Credit Limit Procedures: Application of Offsets in the Prudential Margin Calculation Issues Paper

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Operator's (AEMO) Issues Paper on the application of offsets in the prudential margin calculation.

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.

General Comments

ERM Power keenly participated in the Australian Energy Market Commission's rule change consultation, and welcomed the potential of offsetting trading and reallocation amounts in the prudential margin calculation. We have strongly supported the rule, as it should provide benefits to stand-alone market participants who have been unable to leverage off vertical integration, and efficiently use their hedging position to minimise their prudential margin.

The facility intends to provide participants the opportunity to utilise collateral more efficiently and lower their Maximum Credit Limit (MCL). It is therefore critical that the procedures developed by AEMO are practicable, reasonable and appropriately balanced to the likelihood of risk, not to impede the usability of the facility to achieve its desired aim.

We are generally comfortable with AEMO's procedure change proposal, and commend AEMO on providing tools such as the MCL calculator to assist participants in forecasting the impact of using reallocations. However, we suggest there are two issues that may affect the workability and use of reallocations. We expand on these issues below, and we would welcome further discussion with AEMO on our concerns.

Opting in or out of ex-ante reallocations

We understand AEMO has sought to minimise risk of being unable to acquire additional prudential support from participants, should there be a reduction or removal of a reallocation's offset capability, by extending the reallocation timeframe out to 14 business days. Whilst we support the concept of full offset and opt in flexibility, we believe the earlier reallocation lodgement requirement inhibits the choice of reallocation products available for participants and flexibility to use reallocations as a risk management tool.

This outlook improves somewhat if participants are provided with the opportunity to use reallocations as ex-post if opting out (or the counterparty opting out) of applying the reallocation to be used ex-ante during the 14 business day period. Conceptually, if the reallocation is maintained during the 14 business days, it is treated as ex-ante and applies to the MCL calculation, or, if during that 14-business day period a participant opts out, the reallocation is treated as ex-post. It is unclear if the draft procedures allow a reallocation to exist as both an ex-ante and an ex-post depending on whether the participants have opted in or not, and we seek clarification from AEMO for this scenario.

The process for estimation of generation

AEMO has proposed that, where a generator exhibits significant differences in generation levels between 35-day outstanding periods within the past 12 months, an assessment of daily generation for inclusion in the MCL calculation considers the lowest average generation over an appropriate period (excluding outages). ERM Power considers this approach may be limited in providing a realistic estimation of generation from peaking generators, such as scheduled gas fired generators that are more likely to dispatch at high pool price periods.

There may be prolonged periods when such generators are not dispatched and therefore would be provided with a zero offset. It may be more reasonable to account for the average generation over a period rather than the lowest average, or the average generation correlated to high pool prices, to ensure scheduled generators' ability to dispatch are considered. We urge AEMO to apply a more pragmatic approach to estimating this type of generation, and that any methodology proposed be made transparent to participants with opportunity for input and consultation.

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

Yours sincerely,

[signed]

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