



21 September 2012

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

*Lodged via AEMC website*

Dear Commissioners,

**ERC0133 – New Prudential Standard and Framework in the NEM, Second Consultation Paper**

Alinta Energy welcomes the opportunity to make a submission in response to the Australian Energy Market Commission's (AEMC) second consultation paper on the National Electricity Amendment (New Prudential Standard and Framework in the NEM) Rule 2012, proposed by the Australian Energy Market Operator (AEMO).

Alinta Energy appreciates AEMO raising the issue of credit offsets in the prudential margin. Alinta Energy agrees this matter requires consideration although we note the issue itself is not the subject of the AEMC's second consultation paper.

**Amending the prudential margin calculation**

Alinta Energy agrees that the draft determination should be amended to ensure it permits the inclusion of reallocations in the prudential margin. This proposition would appear to be uncontroversial and inclusion of such matters in the credit limits procedure would appear consistent with the draft determination to introduce the new prudential standard and is a prudent development.

**AEMO's ability to discount elements**

Nevertheless, Alinta Energy is not satisfied with the strength of a process which grants AEMO significant discretion, particularly in relation to new matters, at such a late stage of the introduction of the new prudential standard. Further, the level of analysis underpinning AEMO's recommendations does not provide confidence in the exercise of the level of discretion contained within the proposal.

AEMO's rationale for the exclusion of the largest generating facility appears underdeveloped, does not provide a cost-benefit analysis of the proposed change or any clarity as to how this amendment would impact the 2 per cent probability of loss given default measure.

For Alinta Energy, this calls into question the division of matters between the National Electricity Rules, where the level of transparency and criteria of assessment is of a higher order, and the credit limits procedure, where a more streamlined process is generally desirable.

Given the significance of the change proposed for generators, the reliance on first principles analysis is not sufficient to satisfy Alinta Energy. Alinta Energy suggests the proposal's position on generating facilities not being reallocated within the reaction period is deficient as the analysis fails to:

- identify the historical incidence and statistical probability of such failure;

- note that physical generator failure is not by its nature the reason for business failure in the National Electricity Market;
- explain the reason why within portfolio physical generation for gentailers or stand-alone generation businesses is considered a greater risk than contracted generation for retail businesses;
- identify the cumulative costs of excluding largest generating facilities from the reaction period across all market participants;
- acknowledge that financial risks and physical failure is factored into the commercial decisions made by generators, retailers and vertically integrated businesses in their hedging, market entry and positioning, and risk management decisions;
- acknowledge that the prudential standard is not the place to resolve any outstanding concerns regarding physical plant risk – i.e. using limits on reallocations to account for possible natural disaster risk is manifestly inappropriate;
- consider the implications for competition and new entry, with small generators being disproportionately penalised when compared with large entrants; and
- identify any limitations of the AEMO proposal including in relation to cross-regional reallocations.

AEMO's analysis places its desktop scenarios outside the prudent risk management arrangements for each individual participant without identifying a systemic failure that requires attention.

Alinta Energy believes AEMO's analysis overstates the risk and importance of physical failure during the reaction period and indeed ignores that contagion risk and National Electricity Market financial resilience is better addressed through the existing work being undertaken by the Australian Energy Market Commission and not discretionary adjustments to the prudential standard.

While on first principles, it would seem appropriate for AEMO to be able to discount elements within the prudential margin calculation as part of the credit limits procedure; without sufficient guidance and an assessment process of appropriate standing, Alinta Energy would be reluctant to endorse such discretion.

#### **Constraining AEMO's ability to discount elements**

Alinta Energy understands that appropriate guidance and constraints on AEMO discretion may be possible.

If the AEMC is minded to do so, restrictions on changes to the prudential standard within the credit limits procedure should be contained by explicit well defined cost-benefit analysis, and tested against the 2 per cent probability of loss given default and contribution to the National Electricity Objective. This would include appropriate consideration of alternatives.

Alinta Energy would be comforted by such explicit, not generally consultation guidelines, to ensure the matters incorporated in the credit limits procedure are prudently assessed by AEMO.

#### **Reference to the prudential standard**

The purpose of the prudential standard is to account for prudential risks between prudently managed businesses in the National Electricity Market and any assessment needs to be guided by this perspective. It could be suggested the current reference to the prudential standard, and the need for AEMO to "have regard" to it, is not strong enough given AEMO will effectively be assessing its own credit limits procedure.

#### **The prudential margin cannot be negative**

Alinta Energy supports the prudential standard not being negative and considers this consistent with the draft determination.

**Conclusion**

Alinta Energy supports finalisation of the existing rule change with inclusion of the reallocation arrangements and explicit principles for determining implementation and any methodologies under the credit limits procedure.

Alinta Energy does not support the proposal advanced by AEMO, and while this consultation is not the required forum, in lieu of another opportunity to comment suggest this matter be consulted on separately by AEMO following the introduction of the new prudential standard. This will allow AEMO to develop a more comprehensive analysis of the issues at hand.

Should you have any queries in relation to the Alinta Energy submission, or wish to discuss these matters more generally, please do not hesitate to contact me on, telephone, 02 9372 2633.

Yours sincerely,



**Jamie Lowe**  
Manager, Market Regulation