



12th May 2011

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: submissions@aemc.gov.au

Strategic Priorities Discussion Paper

Australian Power & Gas (APG) welcomes the opportunity to provide comment on the Australian Energy Market Commission (AEMC) Strategic Priorities Discussion Paper.

Whilst not implicitly identified in the AEMC's paper as one of the AEMC's 3 strategic priorities, APG would like to raise what we believe to be a key strategic priority the AEMC should be addressing.

This strategic priority relates to the issue of credit support. Particularly credit support issues within the wholesale electricity market.

We hold the firm view that current arrangements pertaining to credit support impede new entrants and create barriers to market entry and expansion. These in turn impacts the level of competition in the market reducing benefits to end use customers.

APG is one of the few truly independent retailers operating in the National Energy Market (NEM). Whilst APG has established itself as a key participant in the NEM, with significant customer growth and market activity we continue to find it difficult (if not impossible) to obtain the same spot market credit support offset arrangements that vertically integrated retailers have access to via the Australian Energy Market Operator (AEMO).

APG operates in direct competition to these vertically integrated retailers so our inability to obtain similar arrangements (so as to operate on a level playing field) to those afforded to vertically integrated retailers puts APG (and other independent retailers) at a distinct competitive disadvantage.

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A further factor adding to APG's competitive disadvantage is that these vertically integrated retailers are able to obtain credit support offsets from AEMO for both retail and generation positions across multiple regions.

Currently under the National Electricity Rules (NER) APG can only receive a credit support offset by using ex-ante reallocations. However under the NER ex-ante allocations are only permitted within the same region. As a result there are a limited number of generators within each region that offer reallocation swaps.

If you exclude generators that are vertically integrated with competing retailers this further reduces the number of generators where potential reallocation swaps can be obtained. As a result the cost of obtaining the reallocation swap is such that their commercial effectiveness is significantly diminished to the point where they cease to become a viable option.

This market design results in the outcome of AEMO providing vertically integrated retailers with a competitive (cost benefit) advantage over independent retailers. Such a competitive advantage is to the detriment of the market and ultimately to the detriment of end use customers.

This competitive advantage must be addressed to ensure participants (vertically integrated and independent alike) are operating on a level playing field. APG has long held the view this competitive advantage can be addressed through the introduction of Futures Offset Arrangements (FOA). The issue of the introduction of FOA's have been raised previously however to date we have not seen any movement on this issue which APG finds concerning.

The potential number of counterparties offering FOA's into the market is unlimited. This potential availability of FOA's would lead to a greater level of competition in the provision of and pricing for credit support offset instruments.

The introduction of FOA's would also have the effect of enhancing the prudential arrangements of the NEM by mimimising OTC credit default risks. This would also improve the credit standing of the NEM and therefore assist retailers and generators seeking to expand operations into new regions.

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To date AEMO has not set a time frame for the potential use of FOA's to meet credit support obligations. Previously AEMO has stated that it will only look to implement FOA's once it has established a revised prudential regime for the NEM. This delay will continue to impact non-vertically integrated retailers as they will not have access to more commercially viable alternatives than the existing AEMO ex-ante reallocation agreements.

In order to allow APG (and other non-vertically integrated retailers) to compete on equal terms with integrated retailers and ultimately enhance competition and benefits to end customers the AEMC should look to instruct AEMO to introduce the option of the use of FOA's to meet credit support obligations. This should be done as soon as possible and by no later than 1 January 2012.

APG would welcome the opportunity to further discuss our concerns with you on this key market issue. Should you have any questions regarding our submission please contact Mr. Jesse Warburg on (02) 8005 1735.

Yours Sincerely

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