



25 October 2006

The Chairman,  
Australian Energy Market Commission,  
PO Box H166,  
AUSTRALIA SQUARE, NSW 1215

Submission by email: [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au)

Dear Dr Tamblyn

**Re: Reallocation rule change proposal**

The National Generators Forum has followed with interest the debate on the rule change proposed by NEMMCO, which has the objective of increasing the flexibility of the NEM reallocation mechanism and associated prudential arrangements.

*Generator interest in a strong NEM prudential framework*

Under the NEM rules, generators are obliged to sell all of the energy they produce into the pool of energy managed by NEMMCO, from which all market customers are obliged to purchase their energy. Under the Rules, generators are paid for this energy at least 28 days in arrears, and as such have no option but to provide significant credit to NEMMCO for this period. In the event that NEMMCO is unable to recover funds owed by market customers, the rules stipulate that generators are the parties who will suffer short payment.

Under this arrangement, it is imperative that the credit quality of the pool (ie. NEMMCO) is maintained at a high level. The event of NEMMCO short paying generators due to the default of a market customer is likely to severely impact on the confidence of upstream investors in the market. Such an event would at a minimum affect the cost of capital of participating in the NEM, or at the worst extreme lead to a loss of confidence in the market as an investment destination – with ultimate reliability implications.

Given these implications, the NGF believes any reduction in the credit quality of the pool would be at odds with the market objective. Generators exposure to short payment in any NEM credit crisis, leads us to believe that there is good alignment between the Generator position and the market objective in this matter.

Having made these points, the NGF does support reforms which increase the flexibility and efficiency of the prudential regime, provided they do not reduce the overall credit quality of the pool.

#### *NEMMCO proposal on reallocation, and use of Futures positions*

Our interest in the NEMMCO proposal can be traced back to the NGF's active participation in the NEMMCO Prudential reference group, which was convened by NEMMCO in order to consult with a range of market participants as it developed these enhanced reallocation proposals. That group contained both retailer and generator representatives, and it is worth noting that it reached a consensus view that the proposals from NEMMCO represented an enhancement to the NEM rules.

The NGF has also reviewed the proposed amendment to this rule change that has been put forward by a group of 20 parties. This amendment has the objective of allowing Futures positions to be used to underwrite re-allocation transactions in the NEM.

While we have no fundamental problems with Futures positions being used to underwrite re-allocation transactions, we have concerns over some aspects of this proposal, which we fear may impact on the credit quality of the pool. In particular:

- Uncertainty over how the proposed Futures Offset Arrangements would be treated in the event of the participant involved becoming insolvent.
- Effectiveness of the proposed Futures Offset Arrangements in reducing the credit exposure of a participant (ie. ability to reduce MCL's), given the:
  - Potential time delay between the spot market and futures margin calls;
  - Ability of a clearing participant to cancel the Futures Offset Arrangement at any time.

In our view the case has yet to be made as to why the new *Reallocator* class of participant proposed by NEMMCO does not allow Futures market positions to be used to back NEM reallocations. It would appear to us, as it appeared to the reallocation reference group, that many of the risks identified above would be removed from the pool, to be managed directly by a clearing participant registered as a *Reallocator* under the NEMMCO proposal.

We ask the Commission to take these concerns into consideration in its deliberations, and to ensure that any Rule changes maintain the existing credit quality of the NEM pool. Please contact me if you would like further discussions on these matters.

Kind regards

John Boshier  
Executive Director