Ergon Energy Queensland Pty Ltd

Submission on the *Credit Limit Procedures*

Australian Energy Market Operator

23 July 2012

Submission on the *Credit Limit Procedures*
Australian Energy Market Operator
23 July 2012

This submission, which is available for publication, is made by:

Ergon Energy Queensland Pty Ltd
PO Box 15107
City East
BRISBANE QLD 4002

Enquiries or further communications should be directed to:

Jenny Doyle
Group Manager Regulatory Affairs
Ergon Energy Corporation Limited
Email: jenny.doyle@ergon.com.au
Ph: (07) 4092 9813
Mobile: 0427 156 897

1. INTRODUCTION

Ergon Energy Queensland Pty Ltd (Ergon Energy), in its capacity as a non-competing area retail entity in Queensland, welcomes the opportunity to provide comment to the Australian Energy Market Operator (AEMO) on its *Credit Limit Procedures* (Procedures).

Ergon Energy has structured this submission into the following sections:

- Section 2 outlines our key issues and preferred positions in response to the Procedures; and
- Section 3 provides our detailed comments, in tabular form, on the proposed drafting of the Procedures.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should AEMO require.

2. KEY ISSUES

This section discusses Ergon Energy's key issues and preferred positions in response to the Procedures. Ergon Energy believes these key issues require further consideration by AEMO.

2.1. Changes to Credit Support

2.1.1 Notification Process

As highlighted in our submission on the *New Prudential Standard and Framework in the NEM* Rule change request,[1] Ergon Energy considers that Market Participants should be notified in a timely manner of any changes to the prudential settings, and that sufficient time should be provided for new guarantees to be executed and lodged with AEMO.

The current bank guarantee process typically takes three to four weeks. In addition to this process, Market Participants are required to procure the new guarantees at least 10 business days before the new limits come into effect as per clause 3.3.6(a) of the National Electricity Rules (the Rules). That is:

> If:
>
> (1) a *credit support* provided to *AEMO* by a *Market Participant* under this rule 3.3 (called the **existing *credit support***), is due to expire or terminate; and
>
> (2) after that *credit support* expires or terminates the total *credit support* held by *AEMO* in respect of that *Market Participant* will be less than the *Market Participant's* maximum credit limit,
>
> then at least 10 *business days* prior to the time at which the existing *credit support* is due to expire or terminate the *Market Participant* must procure a replacement *credit support* which will become effective upon expiry of the existing *credit support* such that it complies with the requirements of this rule 3.3.
>
> **Note**
>
> This clause is classified as a civil penalty provision under the National Electricity (South Australia) Regulations. (See clause 6(1) and Schedule 1 of the National Electricity (South Australia) Regulations.)

Further, if a Market Participant fails to provide credit support by the appointed time on the due date (a *default event*),[2] then AEMO may instigate actions under clause 3.15.21(b) of the Rules (e.g. issue a default notice). Ergon Energy believes AEMO should take these factors into consideration when notifying Market Participants of the new prudential settings.

2.1.2 Frequency of Reviews

AEMO currently undertakes biannual reviews of the Maximum Credit Limit (MCL) and the Prudential Margin (PM). Ergon Energy seeks AEMO's views on the frequency of the MCL reviews under the proposed Procedures.[3] It is our understanding that Market Participants may be required to prepare guarantees for lodgement with AEMO up to four times a year. That is, a review may be undertaken for each of the following periods:

- Summer season;
- Month of April;
- Winter season; and
- Remaining shoulder season.

This is because the three seasons proposed by AEMO are not clearly segregated (i.e. the shoulder period for the month of April occurs between the summer and winter seasons).

[1] Ergon Energy (2012), *Submission on the New Prudential Standard and Framework in the NEM Consultation Paper*, 6 January 2012, pp3–4.
[2] Clause 3.15.21(a)(3) of the Rules.
[3] Ergon Energy notes that, under clause 3.3.8(l) of the draft Rule, AEMO must review the prudential settings no later than a year after the last determination or review.

2.2. Use of Historical Data

Ergon Energy acknowledges that AEMO has designed the Procedures to:

- "Take account of all available data, using all the RRP [*regional reference price*] and *load* data available for each of the regions of the NEM.
- Smooth changes in *Market Participants'* required MCLs from one season to the corresponding season in the following year resulting from one-off changes to average RRPs and *regional* volatility, while responding to longer term trend changes.
- Provide for Market Participant specific factors to be taken into account where these characteristics differ from those of the *region*." [4]

However, as noted by AEMO,[5] the estimation process and the information used in calculating the Procedures are both backwards looking. Ergon Energy is concerned that using historical load data will impact our prudential requirements going forward. This is because as a non-competing retailer, our load requirements are likely to decrease in the future as customers churn to other retailers.

2.3. Participant Risk Adjustment Factor

The Procedures have introduced a Participant Risk Adjustment Factor (PRAF), which is a Market Participant specific factor calculated by AEMO and used to adjust the PM and the Outstandings Limit (OSL). A separate PRAF is calculated for a Market Participant's load, generation, energy and swap reallocations and cap reallocations. For the load PRAF, the calculation is:

$$PRAF_{L,R} = MAX\ [LWPR_{L,R},\ (LWPR_{L,R})^2].$$

Ergon Energy seeks an explanation from AEMO on the application of the square to the Load Weighted Price Ratio (LWPR) in the PRAF formulas. This increases both the MCL and PM calculations by the factor of the LWPR.

[4] Page 11 of the Procedures.
[5] Ibid 4.

3. TABLE OF DETAILED COMMENTS

Section	Description	Ergon Energy Response
2	**Purpose** The *prudential standard* means the probability of a *Market Participant's maximum credit limit* (MCL) being exceeded by its *outstandings* at the end of the *reaction period* following the *Market Participant* exceeding its *outstandings limit* (OSL) on any day and failing to rectify this breach, expressed as a percentage, and as specified under clause 3.3.4A. Clause 3.3.4A of the NER defines the *prudential standard* as 2%.	The current drafting of this paragraph is lengthy and does not reflect the definitions contained under clause 3.1.1A of the draft Rule. For example, the *prudential standard* is the "value of the prudential probability of exceedance", whereas the prudential probability of exceedance "means the probability of a *Market Participant's maximum credit limit*…". To improve clarity, Ergon Energy suggests that the Procedures should distinctly identify the *prudential standard* and the *prudential probability of exceedance*.
5	That percentage is determined by clause 3.34.A to be 2%.	This sentence contains a typographical error. Ergon Energy suggests amending the clause reference to "clause 3.3.4A".
5.1	• Any other factors *AEMO* considers relevant having regard to the objective of the Procedures	Ergon Energy recommends adding a full stop at the end of this sentence.
5.1	In line with the requirements of the NER, the Procedures determines the MCL for a *Market Participant* as the sum of the OSL and the PM.	Ergon Energy questions the placement of this sentence under its current heading, "Components AEMO must consider in calculating the OSL and the PM", as it relates to the calculation of the MCL not the OSL and the PM. As the MCL calculation is repeated under sections 12 and 12.1, we suggest deleting this sentence.
6.3.1.2	The OSL time period (T_{OSL}) is the typical number of trading days used to calculate a *Market Participant's* OSL. It is based on factors as defined in Schedule 3.3 of the NER.	Ergon Energy understands that Schedule 3.3 of the Rules will be deleted under the draft Rule. Ergon Energy considers this reference should be removed from the Procedures.
7	**The *Outstandings Limit* Calculation** The calculated value is rounded in accordance with Section 12.1.	Ergon Energy notes that Section 12.1 of the Procedures refers to rounding principles for the MCL and PM values only.
10	**Calculation of Participant Risk Adjustment Factor** The calculated value is rounded in accordance with Section 12.1.	Ergon Energy notes that Section 12.1 of the Procedures refers to rounding principles for the MCL and PM values only.
13	Clause 3.3.8(f) of the NER requires that AEMO must review, prepare and *publish* a report on the effectiveness of the methodology in achieving the objective of these Procedures to ensure the *prudential standard* is met for the NEM, with any	Clause 3.3.8(f) of the draft Rule requires AEMO to undertake these activities "at least once a year". Ergon Energy believes the Procedures should be amended to reflect this requirement.

	recommendations for the enhancement of the methodology.	
13.1	Clause 3.3.8(m) of the NER allows *AEMO* at any time, and for any reason that is consistent with the objective of these Procedures meeting the *prudential standard, to* change the *prudential settings* that apply to a *Market Participant…*	Ergon Energy recommends removing the italics from "to".