5 January 2012

Mr Paul Bell
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Submitted electronically

Dear Mr Bell

REFERENCE: ERC0133 - AEMC CONSULTATION PAPER FOR NEW PRUDENTIAL STANDARD AND FRAMEWORK IN THE NEM – AURORA ENERGY SUBMISSION

Aurora Energy welcomes the opportunity to comment on the Australian Energy Market Commission (AEMC) Consultation Paper *National Electricity Amendment (New Prudential Standard and Framework in the NEM).*

Aurora Energy Pty Ltd, ABN 85 082 464 622 (Aurora) is an incorporated, State Government owned fully integrated energy and network business, with complementary activities in telecommunications and energy related technologies. Aurora provides electricity generation, retail and distribution services to more than 270,000 customers in the Tasmanian jurisdiction.

In response to the five questions posed in the consultation paper, Aurora has the following comments:

Platform for Reform of Prudential Framework in the NEM
Aurora agrees that the existing architecture for protection from default is a sound platform to build meaningful reform to the prudential framework.

Ambiguity of the existing Prudential Standard
Aurora agrees that the phrase "*reasonable worst case*" is ambiguous and should be replaced with a more transparent and quantifiable measure. The statistical measure proposed (Probability of Loss Given Default (P(LGD)) appears to achieve this outcome, although its definition may be prone to different interpretations depending on the historical time period in which the statistics are collected. Aurora believes it is appropriate to use a 12 month period to assess the P(LGD) measure due to the potential for change in the nature of energy demand under the carbon tax environment from July 2012.

Probability of Loss Given Default
Aurora agrees that P(LGD) is an understandable statistic. The use of P(LGD) will help manage risk compared to "*reasonable worst case*" if the full details of the P(LGD) calculation are supplied to NEM participants. Aurora wishes to be able to reproduce the calculation of P(LGD) for a given set of input data and

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undertake sensitivity testing to determine possible changes to its prudential margin in advance of AEMO notification.

Additional Changes to Framework

Aurora has undertaken high level analysis on the interpretation of the information supplied in the rule change and has assessed that its prudential requirement will increase under the introduction of the new maximum credit limit (MCL) calculation procedure. Part of this increase is a result of the removal of the "reduced MCL" option. The removal of the "reduced MCL" calculation alone will increase Aurora's prudential costs by approximately 10%. It is Aurora's view that the "reduced MCL" option should be retained in the proposed MCL calculation to enable retailers the option of actively managing their prudential requirements rather than remove the option all together, which would increase prudential costs for those currently utilising the Reduced MCL. Aurora is aware that by maintaining the "reduced MCL" option AEMO would be accepting a greater than 2% P(LGD) but believes this would be an acceptable outcome given that the prudential requirements are actively managed.

Aurora believes that moving to longer periods of reference for the calculation of volatility factors is not in the best interests of calculating the Tasmanian volatility factor. The current method of calculating volatility has been reducing over time for the Tasmanian region and Aurora believes the recent volatility factors reflect the Tasmanian energy market better than the high volatility factors seen during Tasmania's entry into the NEM. As mentioned above, Aurora also believes that the carbon tax will result in a less volatile NEM. For this reason Aurora suggests that a long reference period for the calculation of volatility factor should be time weighted, with less emphasis given to old data and more emphasis provided to recent market outcomes. Consideration should also be given to the exclusion from any historical price analysis of the Tasmanian spot price during the period between Tasmania's entry to the NEM and the beginning of Basslink operation.

Proposed Standard

Aurora agrees that setting of a P(LGD) is optimal maximising the achievement of the NEO however Aurora disagrees that 2% is an appropriate measure to use given that Aurora actively manages its prudential requirements.

If you have any questions on the analysis conducted by Aurora please contact Paul Connor on (03) 62373164 or via email at paul.connor@auroraenergy.com.au

Yours sincerely

Connor

ON BEHALF OF

Nell Bingham
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