origin

6 January 2012

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce

ERC0133: NEW PRUDENTIAL STANDARD AND FRAMEWORK IN THE NATIONAL ELECTRICITY MARKET (NEM)

Origin Energy Limited (Origin) welcomes the opportunity to comment on the AEMC's Consultation Paper on a new Prudential Standard and Framework in the NEM.

Origin supports the work being undertaken by the Australian Energy Market Operator (AEMO) to improve the quality of the existing prudential regime. Well structured and comprehensive prudential arrangements can promote confidence in the NEM through the prudent allocation of risk between generators and retailers.

New prudential standard definition

As recommended in its Energy Market Prudential Readiness Review (Readiness Review), AEMO proposes a Rule change to establish a clear prudential standard and framework. Key to this is providing greater clarity around the prudential standard definition. The Rule change proposal recognises that the current concept of "reasonable worst case" is poorly defined, ambiguous and creates a level of uncertainty for market participants. The market can benefit from introducing a more transparent, predictable and understandable standard that more adequately protects against default in the NEM.

AEMO proposes to adopt a statistical prudential standard of 2% Probability of Loss Given Default (P(LGD)) in place of the reasonable worst case concept. The Rule change also proposes to remove the provisions for the use of the Reduced Maximum Credit Limit (RMCL) and require AEMO to develop new credit limit procedures. The procedures are to include the methodology for determining the minimum amount of credit support a market participant must provide to meet the proposed prudential standard.

Origin supports a more specific and tangible definition of the prudential standard. The proposed 2% P(LGD) prudential standard provides a clearer target for prudential surety. This is an important step towards improving the quality of the prudential regime; it enables greater stability, transparency and certainty around credit support requirements. Consequently, this could contribute to improved investor confidence in the NEM and more efficient investment in, operation and use of electricity services.

Methodology for determining minimum credit support requirements

For market participants, the practical implications of the proposed Rule relate to the yet-to-be-developed methodology for determining the minimum credit support requirements rather than the new standard definition itself. Without that next layer of detail, it is difficult to assess the consequences of the new methodology against the status quo of the existing arrangements, which include the application of the RMCL.

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AEMO has indicated that it intends commencing its consultation on the new credit limit procedures after the AEMC publishes its Draft Determination and Draft Rule. A robust procedures consultation process is necessary to allow market participants an opportunity to undertake appropriate evaluations and analyses of the proposed methodology and provide any feedback to the development process.

Given the importance of the credit limit methodology, we recommend that the AEMC and AEMO overlap their respective consultations. In particular, participants should have sufficient opportunity to consider the methodology prior to the close of submissions to the AEMC's Draft Determination. This allows key stakeholders to consider whether or not there is an appropriate balance of prescription in the National Electricity Rules around the methodology.

Adequate implementation period

Once the new Rule and procedures are finalised, Origin considers that a transition period is necessary to move from the current prudential arrangements to the new arrangements. The length of the transition period should be commensurate with the degree of change between the two regimes. If market participants are required to provide more credit support, sufficient time should be allowed for them to obtain that support.

Future prudential regime developments

We understand this Rule change proposal is the first of a number of recommendations from AEMO's Readiness Review. It is important that the new prudential standard and framework are established before other recommendations are pursued. A solid and well understood foundation is necessary before further possible reforms to the prudential arrangements can be considered.

Should you have any questions or would like to discuss this submission further, please contact Hannah Heath (Manager, Regulatory Policy) on (02) 8345 5500 or hannah.heath@originenergy.com.au.

Yours sincerely

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