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Australian Energy Market Commission

Submission to AEMC New Prudential Standard and Framework in the NEM (ERC0133)

Thank you for the opportunity to respond to the AEMC Consultation on request for Rule change*;* New Prudential Standard and Framework in the (*AMEC Reference ERC0133)*.

Progressive Green is pleased to make this submission, which identifies the significant barriers that exist under the current prudential standard and credit limit procedure for retailers (and their customers) who specifically set out to manage load according to market price, eg Demand Side Participation (DSP). Progressive Green is in support of a proposed rule change and credit limit procedure that includes consideration of such retailers (and their customers) who manage load according to market price. "*If retailers' MCL amounts more accurately reflect the credit risk associated with trading in the NEM, this could free up their capital in certain seasons and give them the opportunity to invest it more efficiently*" (8. AEMO Rule request: EM 2011/003)

Summary

Under the NEM's current prudential arrangements, retailers provide AEMO with credit support to cover estimates of future liabilities likely to be owed with respect to the amount of electricity traded. The existing arrangements do not consider a retailer's correlation between energy use and market price (RRP) specifically the retailers demonstrable utilisation of Demand Side Participation (DSP) of its electricity customers in response to high-price events in the market, which will result in lower credit exposure during high price events in the market and thus a reduced credit risk to AEMO.

The proposed prudential standard should accurately reflect the intended operation of the National Electricity Market (NEM) which is designed to encourage efficiency in the market including the use of DSP during times of constraint on the NEM. Unnecessary barriers (including unnecessarily high credit support) for retailers who actively reduce constraint and encourage efficiency in the NEM should be removed to encourage all retailers to make more efficient use of the NEM.

Under the current credit limit procedure, the significant financial barriers to retailers and customers participating in DSP are summarised as follows, followed by Progressive Green's proposed solutions.

Progressive Green is a licensed electricity retailer established to provide innovative energy solutions for certain 'large' approved customers in Victoria. Progressive Green's Wholesale Managed Pool Purchasing & Monitoring product is a niche-market offering that is suited to sites consuming more than 160 MWh/per annum and are capable of DSP (have proven load management and shedding capability). These large customers have the opportunity via Progressive Green to purchase their electricity at the prevailing spot market prices. As a result these customers provide valuable support to the NEM during times of capacity constraint by voluntarily implementing DSP through their backup generation assets and/or load management capabilities utilising Progressive Green's innovative load management solutions.

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We assist customers in their electricity purchases and load shedding with comprehensive systems for monitoring the market and notifying sites when it is beneficial to shed load. In some circumstances, this is achieved automatically via remotely control from our office. Although our products and services are welcomed by large customers, we are experiencing barriers to this form of Demand Side Participation. These barriers, and our proposed solutions, follow:

Retailer Prudential Security Requirements

Under the existing prudential standard and credit limit procedure AEMO assesses the prudential obligations of retailers and requires them to hold Prudential Security that reflects AEMO's potential theoretical financial loss should a retailer default in its payments for electricity purchases. AEMO's current assessment method and credit limit procedure does not take into account a retailer's ability to reduce customers load in response to the market price via Demand Side Participation (DSP). The new credit limit procedure (Attachment A) proposes to introduce a Load Factor calculation (item 7) as an assessment of a Market Participants load profile to attribute the risk associated with more peaky loads. This will result in higher MCL requirements for retailers with higher risk (peaky) load profiles, but does specifically list the inclusion of the correlation between the retailers energy use and RRP (as described in AEMO Rule request: EM 2011/003, clause 6.1.2). This would substantially disadvantage retailers with peaky loads who carry out in DSP according to market price – incurring an unnecessary financial burden by having to provide security in excess of actual requirements, and other retailers – that have the capacity to manage load – would have no incentive to participate in this form of DSP. Furthermore retailers such as Progressive Green (and their customers) who set out to manage price exposure through DSP rather than through a financial hedge cannot offset any of their prudential obligations through traditional reallocations.

Proposed Solution:

The proposed NEM Prudential Standard and Framework addresses this issue in clause 6.1.2 of EM 2011/003, by including "*The correlation between energy, reallocations and the RRP*" as a <u>key</u> factor in determining the retailers MCL requirements. We propose AEMO include in the new credit limit procedure (method) it uses to assess the retailers risk and credit support, calculation of a factor which reflects any demonstrable change in the retailer's load in response to high market prices. The following provides a fairly simple example of how this factor could be determined.

Over a given period (possibly the same period in which the volatility factor is determined) AEMO could compare a retailers individual average electricity price ($/MWhr) in peak times (eg VIC, 7am to 11pm Mon-Fri) with average market peak electricity price ($/MWhr), using the retailers historical 30-minute load and RRP data for this price calculation. This would provide a direct comparison between the retailer's individual average peak price and the market average peak price over the same period and where a retailer has applied load management in response to price. By incorporating this correlation between the retailer's energy use and market price (RRP) in the Credit Limit procedure, the required security would more accurately reflect the real credit risk under a default condition and release working capital for more efficient uses that improve the NEM and lower customer entry costs for DSP products.

$$\text{Retailers average peak price [\$/MWhr]} = \frac{\text{30min MWhrs x 30min RRP (\$ over the comparison period)}}{\text{total MWhrs (usage over comparison period)}}$$

Progressive Green recommends that AEMO issues a separate discussion paper for further consultation by retailers and generators on the methodology for assessing retailers correlation between energy use and market price (RRP) and how this is used determining the retailers MCL. This discussion paper should also include a thorough review of how the proposed load factor calculation (item 7) will be applied to the retailers MCL calculation and any impacts this will have on assessing the retailer's correlation between energy use and RRP.

Settlement Cycle

In our view the current AEMO 28-day settlement time is unnecessarily long and presents a significant financial burden again tying up working capital that would otherwise be available to support business growth and efficiency improvements.

Progressive Green's Proposed Solution:

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A shorter settlement cycle would further reduce barriers to participation in DSP by small retailers (and their customers), improving cash flow which reduces the risk of loss to AEMO in the event of a default. A shorter settlement cycle should be available to retailers who have predominantly large customers with remotely read interval meters which are generally read on a daily basis.

Going Forward

Credit Support to AEMO is one of the most substantial financial obligations for a retailer, especially for specialist retailers such as Progressive Green who manage customer price exposure through DSP rather than through reallocations. Section 8 of AEMO Rule request: EM 2011/003 describes a new credit limit procedure which would "*Take into account factors affecting the risk of a retailers' portfolio, for example, a retailers' load characteristics. Including factors that better reflect the credit risk retailers pose to the NEM encourages them to make appropriate business decisions regarding risk management strategies of operations".* Progressive Green is in support of a proposed rule change that recognises the retailer's ability to manage (reduce) load in response to high market prices in AEMO's calculation of the required credit support. In our view this more accurately reflects the intended operation of the energy market to send clear pricing signals during times of constraint to encourage DSP and efficient use of the NEM. The current prudential and settlement system may have been appropriate in the past; but in our view will not serve the community in the future.

Removal of the above barriers will facilitate new and innovative systems to be developed, perhaps allowing new retailers to enter the market. However without reform, the system will prevent the potential improvements that will deliver cost-effective improvements and efficiency to the NEM.

David Evans

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