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Australian Energy Market Commission
Level 15, 60 Castlereagh St
Sydney NSW 2000

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Reference RPR0016

Dear Sir/Madam

Australian Energy Market Commission (AEMC) Review of Arrangements for Failed Retailers' Electricity and Gas Contracts Consultation Papers

Thank-you for the opportunity to provide a submission in response to the Australian Energy Market Commission's Review of Arrangements for Failed Retailers' Electricity and Gas Contracts Consultation Paper.

Momentum Energy Pty Ltd (Momentum) is an Australian operated energy retailer, owned by Hydro Tasmania, Australia's largest producer of renewable energy. We pride ourselves on providing competitive pricing, innovation and outstanding customer service to electricity consumers in Victoria, New South Wales, South Australia, Queensland, the ACT and on the Bass Strait Islands. We also retail natural gas to Victorian customers. We offer competitive rates to both residential and business customers along with a range of innovative energy products and services.

1. Overview

This response reflects the views of both Momentum and Hydro Tasmania.

We are firmly of the view that the AEMC should not be seeking to solve the market risk of a very large or first tier retailer failing in either the gas or electricity markets in this review as this is clearly beyond the capacity of the remaining market participants to support. A retailer of last resort (RoLR) event of this size will likely require government intervention as has occurred in the United Kingdom energy market[1] recently.

We believe that any new RoLR rules should not present barriers for retailers to undertake a controlled exit from the market as this will discourage innovative new entrants and not be in the long-term interests of customers.

It is our view that some of the solutions presented under Section 5 of the consultation paper covering electricity contract directions framework (specifically Options 3a, 3b and 4) would present too much complexity to the contract market, risk spreading financial contagion risk from spot markets to hedge markets and/or require changes to contract law to implement. These changes

[1] UK Energy retailer Bulb Energy 1.7m customers placed under special administration by government and regulator in November 2021 https://www.forbes.com/uk/advisor/energy/failed-uk-energy-suppliers-update/

could significantly increase the risks to prospective investors of energy market businesses and therefore inadvertently deter investment away from the energy market. This is particularly relevant as we enter a period where considerable new investment is required for energy infrastructure projects to deliver the proposed transition to renewable generation and the proposed net zero emissions targets[2]. This review should primarily focus on changing the existing energy rules to ensure that cost recovery mechanisms for designated RoLRs adequately reflect the full cost of undertaking this activity. RoLR events usually occur with very short notice during periods of high and volatile market prices and it is vitally important that cost recovery is certain, transparent and promptly reimbursed to the designated RoLR to ensure the ongoing sustainability of the market.

Furthermore, any changes to energy market rules or legislation, under this review, should not significantly increase risks to providers of financial hedge derivatives and affect the liquidity or price of these products to such an extent that they become too expensive for retailers to purchase in order to manage their risks in the market.

2. Specific Responses to the Questions Raised in the Consultation Paper

QUESTION 1: NATURE OF THE PROBLEM 1). Do you agree with, or have feedback on, the problem statement regarding the need for retailers to access supply and/or hedging arrangements to manage increases in customer load following a RoLR event? 2) For default and/or designated RoLRs: a) Have you had trouble accessing contracts on a listed exchange or OTC? If yes, how have you managed sudden increases in customer load to date? b) Do you have evidence of the materiality of RoLR events on wholesale and contracting costs? c) Do you consider access to contracts would assist in managing the risks associated with RoLR events in the future?

Momentum has never been a default or designated RoLR but is aware of the significant wholesale supply risks that it would create as well as the additional customer management issues required to service a failed retailer's customers with limited notice. We therefore support amending the energy rules to provide greater certainly and clarity to the RoLR and the Australian Energy Regulator (AER) for the various cost recovery mechanisms available.

QUESTION 2: RISKS AND COSTS FOR GAS RETAILERS 1. Do you agree with the issues identified with the current section 137 RoLR gas directions framework? 2. Are there other issues with section 137 directions not identified here? If yes, please explain and provide evidence. 3. How material do you consider the issues with section 137 directions are? 4. How material do you consider the problem with the scope of gas directions excluding storage contracts.

Momentum supports the current section 137 RoLR gas directions framework as gas and electricity markets differ. Gas is sourced by physical supply agreements between two parties as opposed to electricity where all electricity is supplied through the National Electricity Market. Therefore, access

[2] https://www.pm.gov.au/media/australia-legislates-emissions-reduction-targets#:~:text=The%20Albanese%20Government's%20landmark%20Climate,will%20be%20enshrined%20in%20legislation.

to gas storage contracts, held by the failed retailer, could assist with managing the gas supply and transmission burden imposed onto a designated RoLR. It is possible that the failed retailer may have used gas storage as an integral part of managing its gas wholesale portfolio and there may be no alternative gas supplies available for the designated RoLR to secure

QUESTION 3: ASSESSMENT FRAMEWORK 1. Are there any other relevant considerations or principles that should be included in the assessment framework?

Momentum makes comments to the assessment framework under questions 4, 5, and 6 below. We are also concerned that some of the proposed changes in this consultation regarding the assignment of contract hedges and financial derivatives may impose an unacceptable risk to the providers of these instruments. This may result in an availability/liquidity problem making it much more difficult for retailers to manage wholesale risk in the energy market. The assessment framework should include this issue.

QUESTION 4: APPROPRIATE ALLOCATION OF RISK CRITERION 1. Do you have views on the likely risk for designated RoLRs in the period following retailer failures? 2. Do you think the risk period is different for electricity and gas? If yes, please identify the proposed risk periods and explain. 3. Do you have views on whether a materiality threshold or trigger is needed for electricity or gas? If yes, please propose a minimum threshold, explain and provide evidence.

The risk periods suggested in the consultation paper (first 3 months following a RoLR event as high risk with the following 12 months considered as lower risk) are reasonable for electricity RoLR events. We believe the periods for gas RoLR events should be extended as gas contracts can cover both gas and gas transportation that may be exhausted by other parties for both the short and medium terms following a RoLR event.

We do not believe a RoLR materiality threshold or trigger is required, as it will complicate the RoLR process, for both the AER and the designated RoLR. Both parties need certainly of the approach to ensure customers are efficiently managed and the RoLR has confidence in how any additional costs are recovered. RoLR events occur with little or no notice and place an immense imposition on the AER and the designated RoLR so the regulatory rules need to be relatively simple and support a seamless transition for all parties involved.

QUESTION 5: INCENTIVES CRITERION 1. Do you see any other adverse incentives that may arise that the Commission should have regard to?

The counterparties to the hedge contracts appear to be over looked, as they may not wish to have their contracts assigned to other retailers. If hedge counterparties (and Australian Securities Exchange (ASX) Clearing Participants) become aware that a contract with a failed retailer could force them to novate their contracts to designated RoLRs, these hedge counterparties may refuse to sell hedges to retailers or charge a premium to account for the regulatory RoLR risk. This could create an increase in the cost of hedge contracts for many retailers and a barrier to entry for new retailers. The proposed changes to contract arrangements under RoLR conditions could increase the incentive for default and designated RoLRs (particularly with generation assets) to game up pool prices to increase the likelihood of competing retailers being forced into (or incentivised) to become suspended, by de-risking such a strategy for the RoLR retailer.

QUESTION 6: PREDICTABILITY AND STABILITY CRITERION
1. Do you see any issues with the principles to support predictability and stability described above? Are they sufficient, or are additional or different principles required or preferable? If yes, please explain why.

As previously noted, the proposed assignment of failed retailer contracts to the designated RoLR presents risks for the counterparties to these contracts that may cause contract prices to be increased accordingly. Another concern is that the designated RoLR may use the "free option", to wait until the contracts are "in the money", before forcing other counterparties to novate the contracts to them.

The option for the designated RoLR to take on the existing contracts creates excessive risks for the original counterparties due to credit risk uncertainty, contractual enforcement uncertainty (the defaulting retailer may litigate to enforce the original contract, meanwhile the counterparty is forced by the suggested framework to sell a duplicate contract to the designated RoLR), thereby doubling the original counterparty's hedge exposure.

QUESTION 8: OPTIONS FOR ELECTRICITY DERIVATIVES CONTRACTS
1. Do you prefer a particular option above others? If yes, please explain.
2. Are any other solutions not listed here that warrant consideration? Please explain and provide evidence.

The initial options the Commission has developed include:

> ***1. Cost recovery clarity****: Clarify that RoLR cost recovery available to the designated RoLR includes wholesale and hedging costs. Best of original options.*
>
> ***2*****.** ***Matchmaking service****: Introduce an automatic information gathering provision by the AER allowing it to obtain from the failed retailer all contracts it holds and to allow the AER to share that information with the designated RoLR.*
>
> ***3*****.** ***Introduce a directions framework****: Similar to what currently exists for gas, where directions are issued to the failed retailer and counterparty to the contract, requiring them to negotiate a new contract with the designated RoLR. Two proposed options for consultation are that:*
>
> > ***a)*** *contracts should be negotiated with reference to the current market price; and*
> > ***b)*** *contracts should be negotiated with reference to the contracted price.*
>
> ***4. Use the failed retailer's 'in the money' electricity contracts to minimise RoLR cost recovery****: Introduce a new RoLR cost recovery mechanism where the wholesale and contracting costs the designated RoLR incurs to manage taking on the failed retailer's customers are paid for by the failed retailer through the sale of its electricity contracts following a RoLR event. If some or all of the value of the failed retailer's contracts can be accessed and used for this purpose, amend the RoLR cost recovery to only include any net costs incurred by the RoLR in taking on the failed retailer's customers.*

Momentum supports option 1, the "cost recovery clarity" solution as it does not affect commercial contracting in the hedge market and could be readily delivered via the National Energy Retail Law (NERL). We have significant concerns with the options 2, 3(a), 3(b) and 4 as they present additional risks and cost to the providers of commercial contracts, are complex to implement, and could reduce liquidity in the hedge contract market. Moreover, these options increase the complexity of the contracting market affecting all parties including the insolvency practitioner if appointed after a RoLR event.

Alternative Option

We propose an additional voluntary option (in conjunction with option 1) whereby the rules could utilise the existing Australian Energy Market Operator (AEMO) ex-ante reallocation and Maximum Credit Limit (MCL) mechanisms to encourage retailers to pre-emptively establish futures and swap based ex-ante reallocations of their proposed load. Given the futures market hedge liquidity far outstrips over the counter (OTC) hedges, AEMO could introduce futures based ex-ante reallocations of retailers load. This would permit AMEO to merely transfer the futures reallocations or swap based reallocations held by the defaulting retailer, to the designated RoLR in the event of a retailer's market suspension. AEMO could unilaterally (or at the discretion of the designated RoLR) transfer any "in the money" AEMO ex-ante reallocation hedges in favour of the designated RoLR. Retailers could be incentivised to enter into ex-ante reallocation contracts with AEMO to achieve MCL prudential offsets and AEMO could lift MCLs commensurately with observable futures energy price rises. This would incentivise retailers to increase futures reallocation hedges with AEMO as increases in designated RoLR hedge contract exposure rises along with hedge price increases.

The benefit of this approach is that it does not affect the risk of counterparties of hedge contracts in the case of futures based ex-ante reallocation, or in the case of a swap based ex-ante reallocation only sellers of such reallocation hedges would be impacted, rather than increasing risks and undermining liquidity across the wider contract market.

QUESTION 9: OPTION 1 KEY POLICY ISSUES 1. Do you agree or disagree with the initial observations for option 1? Please explain and provide evidence. 2. Do you have specific feedback on any aspect of option 1 including feasibility or implementation?

The "cost recovery clarity" option 1 is the most feasible option as it presents the least administration, legal implications and uncertainty to the designated RoLR and the counterparties of the failed retailer. The designated RoLR can simply claim the prevailing market cost (plus load shape risk) that it would incur to establish a hedge for taking on the failed RoLR's customers load.
This amount could then be paid to the designated RoLR as a one off compensation payment together with any relevant administrative charges.

QUESTION 10: OPTION 2 KEY POLICY ISSUES 1. Do you agree with the initial observations for Option 2? Please explain and provide evidence? 2. Do you have specific feedback on any aspect of Option 2 including feasibility and implementation?

This option 2 "match making service "appears fairer to the counterparties of the failed retailers' contracts as it only provides details of existing contracts that the failed retailer may have with its counterparties. It does not mandate the assignment of these contracts to the designated RoLR. However, it may not result in new contracts, with the designated RoLR, that would reflect the regulated contract prices offered to small customers under a RoLR event.

QUESTION 11: OPTION 3A KEY POLICY ISSUES
1. The Commission recognises this option is complex and may raise practical and legal challenges. We therefore seek stakeholder feedback on the following:
a) barriers to either gaining the agreement to transfer contracts or for issuing a direction to a financial institution (such as ASX Clear (Future) or a financial institution)?
b) implementation challenges — how broad are the legislative changes may be needed to give effect to this option?
c) appropriate triggers for the making of a direction?
2. Do you agree or disagree with the initial observations for option 3a? Please explain and provide evidence.
3. Do you have specific feedback on any aspect of option 3a including feasibility, implementation or detailed design?

Option 3A introduces a directions framework with reference to the current contracts but at the current market prices. It is similar to what currently exists with gas where directions are issued to failed retailers and counterparties to their contracts.

The directions would have two parts following the RoLR event and transfer of customers to the designated RoLR:

- *Part 1. For a pre-defined high-risk period — a direction from the AER to the failed retailer and counterparties to the failed retailer's contracts to provide to the designated RoLR, either through contracts or payments, the equivalent price protection provided by any hedging instruments identified by the AER; and*
- *Part 2. For a predefined medium-term period — a direction from the AER to the failed retailer and counter-parties to the failed retailer's contracts to negotiate new contracts with reference to current market prices.*

The AEMC has commented that the intention of this option would be to facilitate the transfer of electricity contracts between the failed retailer and the designated RoLR. We also agree with the AEMC that in the case of exchange traded hedges this would require the consent of the clearing house (and/or Clearing Participants) to these contracts, which reinforces our view, that this is not a viable option. We believe option 3A is extremely complex, uncertain and difficult to implement.

QUESTION 12: OPTION 3B KEY POLICY ISSUES
1. The Commission notes this option is likely to be complex to implement and may have unforeseen consequences. The Commission seeks stakeholder feedback on the following:
a) adverse market impacts in requiring that a contract be negotiated on its original terms?
b) barriers to issuing a direction to any entity including a financial institution (such as ASX Clear (Futures)) to negotiate a contract at the initially agreed (book value) price?
c) implementation challenges — how broad are the legislative changes that may be needed to give effect to this option?
d) appropriate triggers for the making of a direction?
2. Do you agree, disagree or have feedback on the initial assessment for Option 3b? Please explain and provide evidence.
3. Do you have specific feedback on any aspect of Option 3B including feasibility or implementation?

Option 3B introduces a directions framework with reference to the current contract at the

<u>contracted price</u> and again it is similar to what exists under section 137 for gas. The directions would have two parts following the RoLR event and transfer of customers to the designated RoLR:

- *Part 1. For a pre-defined high-risk period — a direction from the AER to the failed retailer and counterparties to the failed retailer's contracts requiring them to provide to the designated RoLR, either through contracts or payments, the equivalent hedge protection provided by any hedging instruments identified by the AER.*
- *Part 2. For a predefined medium term period — a direction from the AER to the failed retailer and counterparties to negotiate new contracts with reference to the current contract at the original price the failed retailer paid for the contract.*

Momentum does not support options 3A or 3B as they are multifaceted and could deliver the following unintended consequences:

1. destroy hedge market liquidity as hedge sellers will be less likely to sell to retailers or will demand a designated RoLR risk premium;
2. create a barrier to entry for new retailers due to increased hedge costs that could result in higher electricity prices to consumers;
3. cause affected counterparties to litigate against the designated RoLR direction;
4. encourage vertical integration and/or deter independent retailers which need to source hedges in the market but will likely have to pay a premium to counterparties or be refused access to risk management hedges; and
5. exchange clearing participants (if captured in the direction orders) may respond by refusing to provide futures clearing services to retailers due the RoLR regulatory risk.

QUESTION 13: OPTION 4 KEY POLICY ISSUES
1. The Commission notes this option has some challenges and is exploring the legal issues associated with this option. We seek stakeholder feedback on the following:
a) if the RoLR event is triggered by insolvency official appointment, how would this intersect with the line of creditors for the failed retailer?
b) whether and how a fund or separate place for proceeds of contracts may be held in the event of retailer failure?
c) implementation challenges — how broad are the legislative changes that may be needed to give effect to this option?
2. Do you agree or disagree with the initial observations for option 4? Please explain and provide evidence.
3. Do you have specific feedback on any aspect of option 4 including feasibility, implementation or detailed design?

Option 4 seeks to initially recover costs incurred by the designated RoLR from the failed retailers' in the money' electricity contracts if they exist. It also makes it clear that cost recovery includes wholesale and/or hedging costs incurred to serve the additional customers assigned to the designated RoLR for a defined period.

This option has the intent of removing any prospect of a retailer attempting to profit by initiating a RoLR event to remove its customer load and subsequently sell it's "in the money "wholesale/hedge contracts. Our concern is that a retailer could still deliberately sell all its "in the money wholesale/hedges", before becoming suspended by AEMO. Suspension by AEMO does not require the retailer to be in administration or insolvent but the retailer may deliberately ensure that it has no assets left to contribute to the compensation of the designated RoLR's costs.

At any point in time, futures contracts held by a retailer are marked to market at fair value, with net in the money profit paid in cash to the retailer each day. This value is paid to the retailer by their clearing participant every day the futures price goes up so even if the retailer still held exchange traded hedges at the time of suspension by AEMO, all the profit from their hedges would likely already be withdrawn by the retailer prior to becoming suspended.

Momentum agrees with the AEMC, which has acknowledged, the implementation of this option, presents huge challenges covering corporate law and legislative changes. The likelihood of funds being recovered from a failed retailer appear minimal and therefore proceeding with this option does not appear to deliver a reasonable cost benefit outcome.

QUESTION 16: NATURE AND MATERIALITY OF THE PROBLEM 1. Do you consider that the above retailer behaviour is an issue that should be considered further in this Review? 2. Do you consider this is a material issue? If yes, please explain and provide evidence.

The ongoing sustainability of the market following a RoLR event should be the key objective of this review as most RoLR events occur during periods of high wholesale prices often placing unmanageable costs onto designated RoLRs. The RoLR rules should be amended in order to provide clarity and certainty of the cost recovery mechanisms available following a RoLR event. We do not believe that the alleged recent behaviour of a few minor retailers warrants undermining the efficiency of the electricity hedge market, or creating unnecessary barriers to entry for retail businesses that operate in a highly competitive market. It may very well be that the solution selected, to improve recovery of the costs of the designated RoLR, will also go some way to minimising the alleged recent behaviour by some retailers but that outcome should not come at the expense of hedge market efficiency or retail competition.

Should you require any further information regarding this submission, please don't hesitate to contact me on 0478 401 097 or email randall.brown@momentum.com.au

Yours sincerely

[Signed]
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