

Paul Smith
Chief Executive
Australian Energy Market Commission

By online submission:

25 September 2014

Dear Paul

RE: NEM Financial Market Resilience Second Interim Report (EMO0024)

GDF SUEZ Australian Energy (GDFSAE) appreciates the opportunity to comment on the AEMC's NEM Financial Market Resilience Second Interim Report (Interim Report). This has been a long review process and GDFSAE acknowledges the thorough manner in which the AEMC have examined the various issues, and sought to engage with industry.

The review has examined a number of different areas relevant to the financial resilience of the NEM including financial interdependencies, OTC derivative contracts, risk management practices, participant failure and retailer of last resort arrangements. Our comments in regard to this review are set out below.

General Comments

The Interim Report contains the statement "The current arrangements for managing and responding to threats to financial system stability in the NEM are inadequate"¹. GDFSAE believes that this statement is not supported either by experience in the NEM to date, or by the analysis carried out in the NEM Financial Resilience review. On the contrary, experience to date has shown the NEM to be resilient to participant failure and supply uncertainties, and with the exception of certain elements of the ROLR provisions, the review has not been able to identify specific shortcomings.

Notwithstanding the concern noted above, GDFSAE acknowledge that seeking to improve certain elements of the financial stability in the NEM is prudent, provided that any new measures are properly targeted to a specific problem, are a proportionate response to the identified problem and do not introduce significant new risks or inefficient costs.

GDFSAE supports the AEMC's decision not to proceed with introducing additional measures that would seek to reduce the probability of financial contagion through counterparty failure. GDFSAE agrees with the AEMC's conclusions that such measures would impose substantial costs on industry participants, and would not adequately take account of the specific nature of financial risks in the electricity sector, and the important distinctions from the financial sector.

¹ Page vi AEMC Second Interim Report NEM financial market resilience 14 August 2014

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We support the AEMC in its conclusion that a case for the proposed reforms relating to Over-The-Counter (OTC) derivatives developed by the G20 countries for electricity participants has not been made, and therefore cannot be supported.

Comments on proposed framework for managing failure of a systemically important market participant

GDFSAE supports the proposed classification of large retailers as 'Systemically Important Market Participants' (SIMPs), and establishment of a separate framework to facilitate suitable response to a SIMP in distress / failure. Care will be needed with the definition of the SIMP to avoid a sudden increase in compliance burden for a gradually growing retailer that crosses the defined threshold.

GDFSAE is inclined to support the proposal that government would have responsibility as the ultimate decision maker following a SIMP failure, subject to an overall objective to maintain financial system stability. It will be important that decisions are made quickly, predictably and transparently, and so government will need to ensure that it assigns and maintains suitable, adequately briefed ongoing resources to this function.

The proposal that government act as the single decision maker on whether to allow a failed SIMP sufficient time to rectify its financial situation, could be effective in enabling market based solutions to work prior to imposing any regulatory outcome. However, these decisions will need to be applied consistently and impartially, so decision guidelines and principles would need to be established up front.

The COAG Energy Council chairperson would seem an appropriate choice as the government decision maker, and close cooperation with State and Territory energy ministers would be important.

Although broadly supportive of these measures to allocate decision making powers to government, GDFSAE is concerned that a federal and state decision making body such as this may not be sufficiently agile to respond quickly and decisively during a ROLR event. GDFSAE would therefore need to be assured that these concerns could be alleviated effectively before we could fully support this proposal.

The NEM Resilience Council comprising representation from AER, AEMO and AEMC is supported. However, it will be important that processes are adopted to ensure that NEM Resilience Council continues to act transparently and consistently.

Alternative stability arrangements

We support the AEMC decision not to proceed with the special external administration or management in the event of a SIMP failure.

The interim report notes that in the event of a SIMP failure, the ROLR may not be effective, and external administration under Australian law cannot be relied upon to ensure continuity of supply and NEM financial stability. This conclusion gives rise to an expectation that government would need to intervene to prevent cascading participant failure.

We do not believe that the AEMC have made a sufficient case for their proposal that the COAG Energy Council establish a working group to develop detailed design of special external administration. We believe that the good track record of the NEM to date, strengthened by the proposed improvements to the framework and ROLR arrangements should provide sufficient comfort that the NEM financial resilience is robust.

Comments on ROLR recommendations

GDFSAE agree that the proposed changes to the ROLR are likely to result in more effective sharing of the risks across the market due to a participant failure.

GDFSAE supports the proposed revisions to ROLR cost recovery arrangements to provide the ROLR greater certainty in quickly recovering its ROLR costs, and thus reducing the risk that the sudden costs imposed on the ROLR might cause its failure.

We understand the principle of the AEMC's proposal to limit the customer base to which ROLR arrangements apply. However, we are concerned that it could undermine competition at the high-usage end of the market and entrench the position of the first tier retailers. Smaller retailers are unlikely to be able to offer high-usage customers' ROLR insurance and thus, even though a smaller retailer has incurred the expense of acquiring the business of a high-use customer, they face the prospect of their "win" being undermined by the continuing ROLR relationship the first tier has with the customer. In other words, those retailers able to offer ROLR insurance may use the ROLR discussion as an opportunity to entice the customer away from the existing retailer. We are concerned that the proposal may have unintended consequences for competition in the large-user market.

GDFSAE supports the proposal to delay a ROLR's additional credit support obligations for AEMO and distribution network service providers, as this will reduce the immediate financial impact on the ROLR, and distribute the cost burden more evenly across NEM entities.

Continuing to smooth the AEMO and AER information and systems to enable the seamless transfer of customers from one retailer to another is also supported.

Comments on market suspension

GDFSAE agrees with the AEMC's conclusion that the rules need to be clarified on whether a participant can continue to operate its generation assets in the event that the same participant's retail function is under administration.

As noted by the AEMC, allowing a participant that is under external administration to continue to trade in the market would allow the opportunity for the participant to trade its way through the failure event, prevent possible security concerns from withdrawing generation supply, and allow any corporate rescue initiatives to be explored.

GDFSAE agrees with the conditions proposed by the AEMC which would apply to a participant under external administration being allowed to remain operating in the market.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Chris Deague".

Chris Deague

Senior Market Specialist