



25 September 2014

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

Submitted online: www.aemc.gov.au

Dear Mr Pierce

EMO0024 - NEM financial market resilience - Second Interim Report

Origin Energy (Origin) welcomes the opportunity to provide comments to the Australian Energy Market Commission's (AEMC) Second Interim Report on the National Electricity Market (NEM) financial market resilience.

Origin appreciates the policy intent of this review process in that we share the AEMC's desire for a robust electricity market that is resilient to financial shocks. There is sufficient indication that such a market currently exists and that what is needed is incremental improvements to the current framework. We are pleased that the AEMC has now concluded that there is no basis for applying the group-of-twenty (G20) reforms to electricity over-the-counter (OTC) derivatives. Additionally, we strongly support the AEMC's decision to not pursue some of the more stringent regulatory interventions that were discussed at the previous stage of this consultation process.

We note that one of the primary reasons for rejecting the above measures was that their introduction *'would require substantial resources and expertise to be effective...[and that] the costs of doing so would likely outweigh the potential benefit to reducing risk in the NEM.'*¹ Origin considers that this is a prudent means of assessing the suitability of any proposed regulatory measure in this space. With this in mind, we are of the view that the proposed special external administration framework is not aligned with this principle, and is in fact a disproportionate response to any residual risk in the NEM. The policy objective should be not to attempt to reduce the level of risk to zero but to make it acceptably low.

Our specific comments on the various aspects of the Draft Report are set out in the attached submission, and summarised below:

Amendments to the Retailer of Last Resort (ROLR) regime

Origin is supportive of a number of the AEMC's draft recommendations, including the deferral of credit support and ensuring that the ROLR is able to recover its reasonable costs. We do not, however, support the exclusion of customers above 10GWh given the practical difficulties associated with this. The need for this provision is negated by the proposal to delay the appointment of the ROLR which would allow for a more appropriate distribution of large customers amongst a number of ROLRs, minimising risk. It should be noted that Origin continues to maintain that the appointment of the ROLR should be expeditious and occur as soon as practicable.

¹ AEMC 2014: Second Interim Report NEM financial market resilience, executive summary, pg vi

Stability mechanisms - special external administration

The proposed special administration arrangements are not a reasonable response to any residual risk in the NEM. The notion that the current administration arrangements are inconsistent with the National Electricity Objective (NEO) - to the extent that they should be completely abandoned - is unproven.

Responding to a large participant failure - NEM resilience council

Origin does not support the establishment of a NEM-resilience council as set out in the interim report. We agree that coordination amongst key entities will be crucial in the event of a failure of a major entity, but consider that current arrangements allow for this to occur. If it is deemed necessary to establish a group to contemplate such issues, then it must include industry, have clear objectives, and avoid scope creep.

Market suspension under the National Electricity Rules (NER)

Origin supports amending the NER to allow the generation assets of a failed retailer to continue operating in the NEM.

Should you have any questions or wish to discuss this information further, please contact Ashley Kemp on (02) 9503 5061 or ashley.kemp@originenergy.com.au.

Yours sincerely,



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Manager - Wholesale and Retail Regulatory Policy
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1. Amendments to ROLR

The AEMC has recommended a number of improvements to ROLR, many of which we support.

Revised ROLR cost recovery arrangements

Origin strongly supports provisions that would allow for the ROLR to recover its reasonable costs. The proposal to bring forward any substantial costs borne by the ROLR will also help to lessen any concerns around the inability to recoup these costs in a timely manner.

Delayed designation of ROLRs

Origin has reconsidered our position on the delay of the appointment of the ROLR. The Draft Report's commitment to the timely recovery of the ROLR's reasonable costs is likely to help minimise any risks associated with a delay in appointing the ROLR. We do maintain, however, that there should still be provision for the pre-registration of both firm and non-firm ROLRs, and that the appointment of the ROLR should be done in an expeditious manner and as soon as practicable. The advantage of delay is that it could allow for additional time for arrangements to be made to manage the administrative and financial requirements from integrating a large number of customers, whilst giving the AER sufficient time to more prudently apportion customers.

Deferral of credit support requirements

The AEMC has accurately identified the significant scale of credit support requirements, and that they are of systemic importance.² The current Rules apply a rigid approach to credit support requirements that could create a risk of cascading retailer failure where credit support is not established within timeframes identified following a ROLR event. Delaying, and increasing the flexibility in the provision of credit support requirements is likely to minimise this risk, by allowing the ROLR additional time to arrange credit facilities. Given the magnitude of the credit support that could be required in some instances, there may also be a role for government in this space. Government providing credit support following a ROLR event should be viewed in the context of ensuring the continuity of supply by helping to mitigate the risk to a viable business that has incurred the regulatory requirement to accept customers of a failed competitor.

Excluding customers over 10GWh

Origin recognises the in-principle appeal of excluding very large customers from the ROLR arrangements as a means of reducing the financial burden on the ROLR. The proposal set out in the Second Interim Report would require customers over 10GWh to secure a back-up retailer within 7 days of a ROLR event or face disconnection. Upon further reflection, Origin is now of the view that such a provision is not needed, and that there a number of issues that could render the proposed arrangements impractical.

There are likely to be numerous critical infrastructure and services customers captured by the proposal across both the private and public sectors. Disconnecting these customers is simply not an option. This is not on the basis of the commercial cost to the customer from loss of production, but due to the direct, economic, and health and safety cost implications the loss of supply to these customers would cause. Origin notes the AEMC's plan to exempt 'sensitive loads' from these arrangements. However, there is an outstanding question as to how such load would be determined. There is also the potential that the list of exempted entities could be greater than anticipated. This calls

² AEMC 2014: Second Interim Report NEM financial market resilience, pg 113.

into question the likely effectiveness of the proposal where a significant proportion of customers are excluded from the option due to their strategic significance.

Additionally, the administrative cost of the proposal is likely to be significant with a customer having to tender for both a primary energy provider and a back-up retailer. It should be noted that such contract negotiations can take months for completion. The costs for retailers too are likely to be significant having to provide quotes not just for primary supply contracts, but also back-up contracts which would only be activated in the highly unlikely event of the failure of a systemically important retailer.

Origin considers that if the intent is to lower the burden on the ROLR, the role of the Australian Energy Regulator (AER), and the proposed delay in the appointment of the ROLR would be instrumental. The AER in appointing the ROLR would be best placed to determine the optimal distribution of the failed retailer's customers; this could be across a number of ROLRs if required. This would help to minimise the burden on any one particular ROLR brought on for example by having to take on too many large customers. This in our view is a more reasonable approach than putting in place a requirement to explicitly exclude very large customers from the ROLR regime. Origin therefore recommends that the current provisions for large customers be maintained, whereby they are given the option of opting out of the ROLR arrangements if they choose to do so.

2. Stability arrangements - special external administration

Origin appreciates (and shares) the AEMC's desire to ensure the stability of the market in the unlikely event of the failure of a major entity. We are of the view, however, that this objective can be achieved through incremental improvements to the current framework. The case has not been made for a fundamental change as stipulated by the adoption of alternative administration arrangements in the electricity market. It is important to remain cognisant that the elimination of all risk is neither possible nor desirable and attempts to do so is likely to impede rather than enhance efficiency. We discuss these issues further below.

Origin considers that the proposed enhancements to the ROLR regime would materially lower the risks associated with the failure of a major retailer. By ensuring an efficient means of cost recovery, and by having a mechanism for the deferral of credit support, the risk of the ROLR coming under stress will be minimised. The outstanding/residual concern expressed in the Second Interim Report seems to be around the potential failure of a vertically integrated entity and the possibility of a withdrawal of its generation assets. Origin agrees that it is important that this generation capacity is made available to safeguard against any destabilising market impacts. We do not, however, agree that the current arrangements preclude this from occurring.

The Second Interim Report concludes that there is a misalignment between the current administration regime and the National Electricity Objective (NEO). The rationale for this assumption is that the focus of a traditional administrator would be to obtain financial recovery for the retailer's creditors, whereas under the NEO the continuation of supply would be paramount. These two objectives, however, are unlikely to be mutually exclusive given that the best prospects for cost recovery for the failed entities creditors is making the generation capacity availability to the market. The most likely scenario is one in which - where there is a demand for this generation, the administrator would make the rational economic decision and opt to make it available to the market so as to reap the financial benefits of doing so. It does not seem reasonable therefore to undertake the time and resource intensive exercise of designing and implementing an entirely new set of administration arrangements to deal with the remote scenario where the administrator chooses to not make this generation available. This is particularly given

that such an unlikely outcome could only eventuate in the case of the failure of a major entity, which itself is a low probability event.

It should also be noted that the implementation of a special administration regime would require changes to existing administration and other contractual arrangements. At a minimum, this would seemingly require changes to Corporation Law and International Swap and Derivative Agreements (ISDA) Master Agreements. Other consequential changes impacting business corporate structures may also be required to promote legal certainty under the scheme. The impact of these changes would have the potential to diminish the rights of secured creditors, and prevent a generator from closing out an OTC contract in the event of default. This could serve as a disincentive to invest/participate in the electricity sector and an increase in risk premiums which would be reflected in higher lending and hedging costs for retailers.

Special administration has been put forward as an alternative to the ROLR regime. However, the AEMC should also bear in mind that the existence of ROLR also provides an incentive for orderly exit from the market where a distressed retailer would most likely first look to sell the business rather than face market suspension and the mandatory transfer of its customers to other retailers.

3. *NEM resilience council*

Origin agrees that in the event of the failure of a major entity in the electricity sector, communication amongst key stakeholders/regulators will be crucial. It is our understanding that avenues for such communication are already in place though a case could be made for enhancements. It is not clear, however, that a new body needs to be established. However, if it is deemed necessary to establish such a body, then it should allow for the coordination of industry participants, relevant jurisdictional representatives, and government agencies.

The rationale of a coordinated approach to decision making is, while jurisdictional governments have a responsibility for energy, it is the participants that own the assets that contribute to the ultimate solution. From this perspective any organisation set up to contemplate issues around the failure of major entity, must include industry representation. Though we are not necessarily advocating for the adoption for this particular model at this point - the National Gas Emergency Response Advisory Committee (NGERAC) is an example of industry and governments working together to mitigate the potential market impacts of a potential supply disruption. It is also crucial that such a body contemplated in this space, is not intrusive and that its focus is aligned to specific objectives.

4. *Market suspension under the NER*

Origin has consistently supported amending the NER to allow the generation assets of a failed retailer to continue operating in the NEM. We recognise the concern that preventing the ongoing operation of generation assets could pose a risk of involuntary load shedding or a loss of continual supply where the withdrawal of capacity causes a loss of available reserves. We recognise further work is required to determine the form an amendment could take to ensure the continual operation of generation assets of a failed retailer.