Submission to the AEMC's NEM Financial Resilience Paper

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1 About GDF SUEZ Australian Energy

GDF SUEZ Australian Energy (GDFSAE), formerly International Power-GDF SUEZ Australia, is wholly owned by GDF SUEZ S.A. and a business line of GDF SUEZ Energy International.

GDF SUEZ Energy International is responsible for GDF SUEZ's energy activities in 30 countries across six regions worldwide (Latin America, North America, UK-Europe, the Middle East, Turkey and Africa, Asia and Australia).

GDF SUEZ Energy International has a strong presence in its markets with 77 GW of gross capacity in operation and a significant programme of 10 GW gross capacity of projects under construction as at 30 June 2012. The business has more than 11,000 employees and generated revenues of €16.5 billion in 2011.

In Australia, the company owns and operates 3,500MW (gross) of renewable, gas-fired and brown coal-fired plants in Victoria, South Australia and Western Australia. Our retail business, Simply Energy, has more than 300,000 electricity and gas accounts in Victoria, South Australia, New South Wales and Queensland.

2 General response to options paper

GDFSAE appreciates the opportunity to comment on the options paper and also for the opportunity to participate in the Commission's reference group on this consultation.

GDFSAE supports the view of the Commission published in the issues paper that *"the financial relationships and markets that underpin the operation of the NEM are generally robust."*

2.1 The risk of financial contagion remains low

In the NEM, participants have successfully managed risks to a variety of exposures. The main exposure is to a volatile spot market but the industry has also successfully managed to withstand a range of other disturbances in the market. These disturbances or price shocks have included physical loss of supply due to industrial action, mine inundation or plant failure, the loss of gas production facilities and the changes in underlying market dynamics that occurred during the peak of drought conditions.

The electricity industry in Australia has also absorbed financial shocks, for example, the collapse of Enron, and the failure of two second-tier retailers, without significant disruption. Financial contagion did not follow any of these events and into the future has a low probability of occurring due to industry practice and existing local regulations (which include Australian Financial Services Licences regulations, retailer of last resort provisions, or "ROLR", and ASIC regulations) and the risk management policies which are set at the board level by national and international electricity and gas businesses.

GDFSAE does not accept the premise that it is necessary to increase the regulatory burden on electricity market businesses, simply because financial market turbulence has occurred overseas in markets generally unrelated to energy.

Further, any measures that "smear" the risk of financial contagion across the energy market simply transfer risk between parties with the likely outcome of higher costs to customers.

2.2 Retailer of last resort regulations and risks faced

Our general view of ROLR regulations is that they are poor in the sense that cost recovery is unclear and it will remain difficult to raise the credit following a ROLR event. At the very least an exercise to align disparate state-based ROLR regulations is worthwhile as is the focus on greater preparedness across the industry to deal with the consequences of a significant ROLR event (provided this is not used as a justification for unreasonable regulations that interfere with commercial operation of retailers).

In addition to credit and cost-recovery concerns, collapse of a large retailer would also present significant operational challenges for any ROLR.

If one of the largest retailers failed and a smaller retailer was compelled to act as ROLR, billing systems would be severely stressed, the overnight increase in the number of ombudsman complaints would be profound[1], it is unlikely that debt collection departments would cope with the significant increase in the number of outstanding accounts, and the significant increase in customer base would be accompanied by a significant increase in compliance burden for the ROLR.

From a second-tier retailer's perspective it is these credit support and operational concerns that are the biggest risks face by a ROLR event.

2.3 The way forward

GDFSAE suggests that any recommendations the Commission considers must be commensurate with the risk of collapse of a large retailer which remains a low probability event.

ROLR provisions are inherently interventionist and greater reliance on heavy-handed regulation (such as compelling a retailer to become a ROLR) over more market-based approaches should be resisted by the Commission.

In the event that a first-tier retailer were to collapse, protecting the ROLR and maintaining the integrity of the wholesale market are critical from GDFSAE's perspective. Our specific comments are provided in Section 3 below.

Of the options presented in the Commission's paper, many simply smear risks across participants or create distortions (for example settlement deficits, wholesale market price controls) which we suggest enhances the risks of contagion. In addition, many of the options presented as market-based appear to rely on enhanced regulation rather than genuine market mechanisms.

Financial contagion cannot be confidently mitigated while risks are simply transferred between market participants. The risks need to be shifted outside the energy market, to an entity which is does not have energy market interdependencies and has a greater financial base on which to draw. GSFSAE considers government to be the only entity able to fulfil this role.

1 These are to the account of the retailer; hence the ROLR absorbs the cost of complaints against the failed retailer, in the order of at least $135 per ombudsman call in Victoria.

3 Specific response to options presented

GDFSAE provides the following commentary on the options listed in Table 4.3 of the Commission's paper.

<u>Chapter 5</u>

Revised cost recovery arrangements

The existing ROLR cost recovery provisions would be amended to give the designated ROLR greater certainty that it can quickly recover its costs

- Under a ROLR event cost recovery is not clear and therefore an exercise to align currently non-aligned state-based regulations on cost recovery is worthwhile.

Enhanced preparation arrangements for a ROLR event

The existing ROLR provisions would be augmented to assist the AER to better prepare for a large retailer ROLR event and facilitate the appointment of multiple designated ROLRs

- The issue of retailer scale is critical. Smaller retailers would be unable to cope with increased operational, credit and compliance issues for which their capital structures, systems and processes are not designed.
- Any wider powers given to the AER to compel retailers to provide commercially sensitive information under the guise of greater ROLR preparedness is an affront to commercial confidence for participants who have done nothing wrong, and is not supported.

Transfer of hedge contracts to the ROLR

The designated ROLR would be granted an option to acquire some or all of the hedge contracts of the failing retailer

- Such a measure introduces third parties into an already costly process. Market mechanisms should be allowed to work so long as the retailer can pass the costs through to the end consumer.

Amending ROLR event triggers

The NEM suspension provisions would be amended to delay the triggering of a ROLR event

As the ROLR trigger is swift, this option simply delays the process. The credit risk however increases for generators during such a delay, and this has the effect of simply transferring risk. The only way to deal with mitigating contagion is to do so externally (dealt with in later options).

Delayed designation of ROLRs

The ROLR regimes would be amended to delay the time at which the designated ROLR is appointed to allow more time to appoint multiple designated ROLRs. The appointment would be backdated to the time of the original ROLR event

- This is the same issue as above. In this case, the ROLR ends up with more risk as it faces risks associated with a position it never knew it had.

<u>Chapter 6</u>

Amendments to AEMO credit support provisions

The increased credit support required to be provided by the designated ROLR to AEMO would be waived or reduced for a short transitional period

- Under this option, if the ROLR fails then risks are simply transferred to generators. It is unacceptable for generators to face greater risk as a result of a retailer failure than would have occurred due to normal counterparty relationships, and undermines the essential purpose of AEMO prudential requirements. While generators already face the ultimate credit risk in the market, this risk cannot be anticipated or managed.

Chapter 7

Spot market price cap

The spot price would be capped at a set price, eg $300/MWh, for a specified period of time following a ROLR event. The cap could potentially apply only to the designated ROLR

- This option disrupts the entire wholesale market economics due to a single party with credit issues. It is likely that a ROLR event would occur during a period of high spot prices. Capping the price for the ROLR leads to a settlement deficit with risks transferred to generators and suppresses the market signals which arise during periods of scarcity that are essential in an energy-only market to ensure long run as well as short run costs can be recovered. This proposal would change the risk position of all parties linked to the wholesale spot price.

Initial period where designated ROLR passes through retail prices

Instead of paying the spot price, the designated ROLR would pay AEMO a "transitional ROLR tariff" (which would be calculated based on the wholesale component of retail prices) for an initial period following a ROLR event

- This could lead to a settlement deficit and could lead to further contagion, and transfers retailer risks to generators who are less able to manage them.

Delayed settlement period for designated ROLR to pay AEMO/DNSPs

The date for the designated ROLR to pay AEMO for energy/DNSPs for network charges would be delayed in relation to the acquired customers

- This option fails to recognise settlement required by generators. AEMO does not have the resources to fund one side or the market.

Industry co-insurance fund

Retailers would be required to pay levies into an industry co-insurance fund. Following a ROLR event, the fund could be used to provide loans or grants to the designated ROLR to cover some of its costs, or used to provide credit support to AEMO

- Under this option an external pool of money would need to exist which can be rapidly injected to manage credit risks. This proposal has some merit, however any such fund would need to be carefully structured with, and would likely rely on, money from customers. Even with such a fund in place, a risk remains that the amount of money in the fund would be insufficient following collapse of a large retailer and the risk of a settlement deficit would remain with generators.

- The option paper discusses similar funds such as the Participant Compensation Fund. A further consideration relates to what role, if any, the Energy Security Council[2] plays, or could play, in the context of the collapse of a large retailer.

Government posts credit support for the designated ROLR

A government entity would post credit support to AEMO to meet the designated ROLR's increased credit support obligations for an initial period following a ROLR event

- By posting credit support the risk of a settlement deficit is defrayed and in a sense the government is providing a form of insurance as a last resort measure. While this suggestion is supported, it would not be reasonable for any last resort government involvement to be accompanied by unreasonable actions which distort commercial outcomes or increase regulatory burdens following any intervention.
- The ideal model is for government support for the ROLR and for the ROLR to be able to recover its costs.

Enhanced administration arrangements coupled with interim government funding

A government entity would appoint an administrator to manage the failing retailer to facilitate a trade sale or orderly transfer of the customers to alternative retailers, as an alternative to the ROLR regime. Could potentially be implemented under existing insolvency laws or they could be amended to introduce a new special administration regime. A government entity would provide funding during the administration. This funding could be recovered from the administrators after any sale of the customers, with any shortfall recovered though an industry levy

- This option is in many ways the least interventionist approach and combines genuine market-based measures with a last resort response from government. It avoids many of the risks outlined with earlier options and is worthy of further consideration by the Commission. The industry levy should be passed through to end consumers.

Government funding, loans or guarantees

Government funding, loans or guarantees would also potentially be available, but do not require any additional mechanisms to be put in place and are not discussed in this paper

- Same issues as government injecting credit support. This option also raises questions as to the role, if any, of the Energy Security Council.

[2] Established as part of the Clean Energy Future legislation