AEMO
AUSTRALIAN ENERGY MARKET OPERATOR

21 October 2014

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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
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By online submission: http://www.aemc.gov.au/Contact-Us/Lodge-a-submission

Dear Mr Pierce

Submission: NEM Financial Market Resilience Second Interim Report, EMO0024

AEMO welcomes the opportunity to make this submission on the Australian Energy Market Commission's (AEMC) Second Interim Report on NEM Financial Market Resilience (the report), and acknowledges the significant amount of work that has been invested by the AEMC and the industry in this review to date.

AEMO supports the need to resolve existing risks of contagion during insolvency events, and is committed to help develop and implement the improvements to the financial arrangements that have been identified. AEMO broadly supports the findings and draft recommendations of the report, and considers the characterisation and assessment of risks to the financial stability of the NEM to be comprehensive.

AEMO remains concerned there is still a material risk that the RoLR process would be unable to prevent financial contagion in the event of failure of a large retailer or gentailer. The proposed incremental improvements to RoLR are likely to extend the range of scenarios under which RoLR would be effective, however AEMO considers these measure would be insufficient to make RoLR effective in the context of a large retailer or gentailer default. In the event of such a default, the existing arrangements may exacerbate the risk of contagion and the failure of the market, and therefore do not promote the National Electricity Objective. Although there may be the ability for governments to step in to manage a crisis, the speed with which such an event could play out would present challenges in the absence of any prior planning and preparation. Accordingly, in order to prevent contagion such scenarios would require an alternative to RoLR which is planned and practised in advance.

AEMO therefore appreciates the importance of developing alternative arrangements, such as the proposed framework for managing and responding to the failure of a systemically important market participant (SIMP) and alternative stability arrangements. AEMO recognises that further work is required to develop these measures, and would be willing to assist this work to ensure the operation of these measures appropriately integrates with the operation of the market and prudential functions.

A number of the draft recommendations are consistent with those in the AEMCs First Interim Report on NEM Financial Market Resilience, including:

- Delayed designation of RoLR – provision of more time for the AER seek additional RoLRs and consider a more optimal allocation of customers.

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- Changes to NEM credit support requirements following RoLR – the increased credit support to be provided to AEMO would be waived for one week, and progressively ramp up to reflect the increase in outstandings over the next four weeks.
- Improvements to the process and systems for managing customer information – AEMO and the AER to explore opportunities for more accurate customer information to be available following RoLR.

AEMO considers that these measures are workable and likely to improve the operation of RoLR, although we reaffirm the points made in our earlier submission[1], and in particular note that the changes would result in some redistribution of risk in the market.

The latest report also includes a number of new measures, and AEMO considers the proposed policy framework for the management of generation following the default event of a major generator or gentailer to be an important risk mitigation measure for the market. AEMO has considered the draft recommendations, and the remainder of this submission sets out a number of practical considerations which are aimed at assisting the AEMC in developing the draft recommendations should it decide to take them forward.

Very large customers excluded from RoLR

AEMO appreciates that under the current arrangements there may be some merit in excluding very large customers from RoLR, as a means of incentivising these customers to make alternative arrangements and reduce the potential impact on RoLRs. However AEMO suggests that further consideration of this measure is required as to how it might operate alongside the proposed large retailer failure and system stability measures. Transferring risk onto very large customers following the failure of their retailer would only be appropriate if it was manageable for those customers and substantially reduced the risk of systemic failure to the market as a whole. There are likely to be challenges in developing the proposed arrangements for a very large customer exclusion in the following areas:

- The determination of whether a customer meets the criteria of being "very large".
- Coordination with jurisdictions and industry stakeholders on what constitutes a sensitive load.
- The arrangements for disconnecting very large customers in the event that they fail to nominate a back-up retailer, and which parties are exposed to the prudential risk if the disconnection cannot be achieved in a short timeframe.

AEMO is also concerned that following a RoLR event its resources are likely to focused on implementing the RoLR and managing the impacts on prudentials, and AEMO may not be well placed to engage with a large number (possibly many hundred) of end-use consumers who notify AEMO of their back-up retailer during the one week grace period.

Clarifying market suspension

AEMO agrees that there are circumstances under which there would be benefits to the market if the generation assets of a failed market participant were allowed to remain in operation. It would therefore be beneficial for the NER to be clear in relation to the power AEMO has to allow a generator to continue trading while insolvent and the circumstances in

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[1] AEMO submission to the AEMC's First Interim Report on NEM Financial Market Resilience, dated 12 July 2013: http://www.aemc.gov.au/getattachment/b80fee9f-1e01-443a-a20f-45c515c4e6ce/Australian-Energy-Market-Operator.aspx

which this can be considered. There are risks in allowing a generator to trade while insolvent, especially in regard to the enforcement of the NER and conditions of registration. Any such arrangements should therefore provide for a broad range of conditions to be applied by AEMO if it makes such a determination.

AEMO would be pleased to assist in the further development of this recommendation, based on its operational experience in dealing with defaulting market participants and external administrators.

If you would like to discuss any aspect of the submission, please contact Murray Chapman, Group Manager Market Policy Development on (03) 9609 8486, or myself on (08) 8201 7371.

Yours sincerely

David Swift
Executive General Manager Corporate Development