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8 November 2013

Australian Energy Market Commission
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Lodged (online): http://www.aemc.gov.au

AEMC Financial Market Resilience - Stage 2 Options Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Australian Energy Market Commission (AEMC) on its review of Financial Market Resilience ("the Review").

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 51,000 people and contribute $16.5 billion directly to the nation's Gross Domestic Product.

A component of the Review is to report on the applicability of the G20 OTC derivative reforms to electricity derivatives. In light of this the Private Generators Group, the National Generators Forum and the esaa asked Seed Advisory (Seed) to prepare a report to assess whether there was systemic risk in the electricity derivative market and consequently whether the G20 reforms were required (**Attachment A, "**the Report").

The Report describes the key risks in the NEM and the risk management strategies and practices that participants currently use. To assess whether there was immediate systemic risk in the electricity derivative market, Seed modelled the potential costs faced by large market participants in the event of two separate scenarios:

1. The collapse of the derivative counterparty that a participant had the largest position with (by volume in MW);
2. The collapse of the derivative counterparty that a participant had an average size position with (by volume in MW).

The model used actual data from seven large market participants. It also used assumptions about the prices in the spot and the derivative market, following the counterparty collapse, which represented a worst case scenario for each type of participant. For example, it assumed sustained high market prices when modelling the costs for a vertically integrated retailer and sustained low market prices when modelling the costs for a large standalone generator. The costs faced by the participants were split into those that were immediate and those that may not eventuate for a few years. This is illustrated on page 31 of the Report. Immediate losses were namely those associated with the missed settlement of the OTC derivatives. Costs that were not as immediate included those associated with derivative contracts that may not necessarily need to be replaced immediately.

The results of the modelling, based on the actual data, were then assessed to determine whether there was concern of immediate systemic risk in the electricity derivative market and whether it warranted the implementation of the G20 OTC Reforms. The Report also provided other options to manage risk in the electricity derivatives market.

Any questions about our submission should be addressed to Fergus Pope, by email to fergus.pope@esaa.com.au or by telephone on (03) 9205 3107.

Yours sincerely

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