Lisa Rautenbach

From: Greg Sise [redacted]
Sent: Thursday, 31 October 2024 5:22 pm
To: TaskForce
Cc: Paul Chapman
Subject: Level Playing Field

This is a response to the request for "stakeholder input on:

- what level playing field measures we should be considering;
- practical examples of level playing field measures being implemented, preferably in comparable overseas electricity markets; and
- existing published work on level playing measures that stakeholders consider would usefully inform the Authority's work."

We are responding to this request based on our experience working with a range of independent retailers since 2017, in particular. Our response doesn't quite fit into the list above, but we want to provide a list of ways in which independent retailers face an uphill playing field. We allude to some potential solutions where these are already at hand. We'd like to provide more input on the list above, but our paid workload limits the amount of time we can devote to public good work.

Settlement & Prudential Requirements (PRs)

Our understanding, and certainly our experience, is that default is most likely to occur when a call is made on the PRs. In theory, a participant without generation can manage spot price risk equally well with hedges. But hedges are financial products and are exempt from GST, which means that even with a 100% perfect hedge strategy, assuming all of an independent retailer's hedges are lodged with the CM, the retailer has a net exposure due to the GST treatment of spot purchases (15% GST) and hedges (no GST).

On the other hand, gentailers' generation does attract GST payments, so it is possible for a gentailer to have a perfect hedge and to have zero PRs.

The GST treatment difference between physical energy and financial products means independent retailers have an unavoidable exposure which gentailers do not have.

Gentailer Credit Requirements

When independent retailers sign up for hedges with gentailers, they are nowadays asked to meet substantial credit requirements, including credit check and some form of bond. This is on top of the independent retailer meeting the PRs set by the CM, the independent retailer reducing their risk by hedging, and having to meet either the wholesale investor test or (for new retailers) the eligible investor test allowing them to trade in hedges.

To add insult to injury, in the event of default by the independent retailer, who most likely gets their customers? The gentailers of course.

Weighted Average Hedge Price

For various good reasons, new retailers almost always initially target mass market residential customers. Their costs to serve are made up of line charges, retailers' non-energy costs, and wholesale energy costs. If a new retailer wants to hedge their (very substantial) spot price risk, then they go to the OTC market for hedges, or perhaps the ASX direct, but in both cases the prices they receive on any particular day are closely linked to the ASX prices on that day.

On the other hand, we know from disclosures of internal transfers prices (ITPs) by gentailers that their ITPs are typically based on averages of ASX futures prices over terms of up to three years.

In a rising market, as it's been since late 2018, gentailers' ITPs lag well behind the hedge prices available to new retailers, which means new retailers struggle to make any margin at all. Even well established and relatively large independent retailers end up having to stop taking new customers during periods of particularly high prices, because the hedge prices on offer are priced such that they would make negative margin.

Of course, the opposite should be true in a falling market, but this 'hypothesis' remains largely untested.

Access to Shaped or Peak Hedge Products

Serving retail customers gives an independent retailer greater exposure to spot prices during the day, which leads to demand for peak, super-peak and shaped hedge products. If the ASX baseload peak futures contract had market-making, it would provide additional liquidity into the peak sector of the market. In our view, not having some liquidity in peak futures is a major gap in the futures-lead strategy followed by the Authority over the last decade and more.

Back in 2019 and 2020 we spent a lot of time working with the gentailers to develop the Flex-CFD shaped hedge product concept, which the Authority has copies of. It would provide independent retailers with load flex as they grow, given how hard it is for these retailers, particularly those that are up to a few years old, to predict their growth.

There may be other ideas out there that we haven't heard of, but we can be sure this market segment is long overdue for more alternatives being available to independent retailers in this area.

Regards
Greg

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