INFORMATION

AEMC initiates review into the arrangements for failed retailer's electricity and gas contracts

Stakeholder submissions invited on new review

The Australian Energy Market Commission (AEMC or Commission) has published a consultation paper and terms of reference for a self-initiated review (the Review) into whether changes are needed to regulatory frameworks to minimise the risks and costs associated with retailer failures. The Review focuses on whether when a retailer fails and its customers are transferred to a Retailer of Last Resort (RoLR), the RoLR should also have access to the failed retailers electricity and gas contracts used to manage those customers (in some form).

Stakeholder submissions must be lodged with the Commission by **10 November 2022**.

Context

Prior to May 2022, we had seen very few retailer failures in Australia's east coast electricity and gas markets. However, in the past five months, seven electricity retailers, one gas retailer and one embedded network operator have failed.

Overseas, energy retail markets with similar characteristics to Australia have also seen significant retailer failures. In the United Kingdom, more than 50 retailers have failed since 2019 including large retailers whose failure could threaten the stability of the retail market.

While entry and exit are important features of competitive markets, impacts on customers from potentially volatile market conditions or rapid exit should be minimised. This has prompted the AEMC to examine whether and how the regulatory framework may be improved to manage the risks and costs with retailer failures.

Failed retailers' electricity and gas contracts

Nature and magnitude of the problem

The RoLR scheme is an important mechanism to ensure the continued supply of an essential service to customers in the event of a retailer failure. When a retailer fails, the RoLR scheme enables the customers of the failed retailer to automatically be transferred to a new retailer, called the designated RoLR. However, the rapid transfer of a (potentially) large number of customers without significant notice represents a material risk and cost for the designated RoLRs. These retailers will not have the appropriate electricity and gas contracts to insure them against high electricity spot prices or to supply gas to supply customers. This is because any electricity or gas contracts that the failed retailer relied upon to manage those customers remain with the failed retailer following the RoLR event.

The transfer of many customers due to a retailer failure presents two potential risks:

- Systemic risk of cascading retailer failures may occur if the retailer failure is too large for the designated RoLR to manage
- Increased costs to the designated RoLR and customers.

Potential solutions — gas

When a gas retailer fails, the Australian Energy Regulator (AER) has existing powers to direct contracts for gas supply and pipeline capacity to the designated RoLR. These directions only apply to contracts that were held by the failed retailer at the time of the RoLR event. The Commission considers it is worth analysing potential improvements to the current RoLR gas directions framework and expanding the directions power to include storage contracts.

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Potential solutions — electricity

Unlike in gas, there is currently no regime for the RoLR to access the contracts of a failed electricity retailer. In Stage 1 of the Review, the Commission is exploring and seeking stakeholder views on the feasibility and merits of potential solutions to address the identified problems. As such, the Commission's analysis of potential options is preliminary, and we welcome stakeholder submissions or discussions on these or alternative potential solutions. The initial options the Commission has considered include:

- Cost recovery clarity: Clarify that RoLR cost recovery available to the designated RoLR includes wholesale and hedging costs
- Matchmaking service: Introduce an automatic information gathering provision by the AER allowing it to obtain from the failed retailer all contracts it holds and to allow the AER to share that information with the designated RoLR
- Introduce a directions framework: Similar to what currently exists for gas, where directions are issued to the failed retailer and counterparty to the contract, requiring them to negotiate a new contract with the designated RoLR. Two proposed options for consultation are that:
    - contracts should be negotiated with reference to the current market price
    - contracts should be negotiated with reference to the contracted price.
- Use the failed retailer's 'in the money' electricity contracts to minimise RoLR cost recovery: Introduce a new RoLR cost recovery mechanism where the wholesale and contracting costs the designated RoLR incurs to manage taking on the failed retailer's customers are paid for by the failed retailer through the sale of its electricity contracts following a RoLR event.

Retailer behaviour during volatile market conditions

Distinct from the issue of retailer failures, the Commission has also noted that in the recent volatile market conditions, some unusual retailer behaviour took place. In particular, one retailer employed strategies to reduce their exposure to high spot prices by more than doubling its retail offers, encouraging its customers to leave and allegedly then selling its in-the-money hedges.

The Commission will analyse and seek stakeholder views on whether this behaviour harmed customers or the market and, if so, whether regulatory changes are needed.

Process for the Review

The Commission notes the Review may identify policy solutions that are complex to implement and may require changes to legislation other than the energy laws and rules. The Review is therefore being undertaken in two parts.

Stage 1: is a feasibility study to identify what policy options are available to address the matters within the scope of the Review and the relevant law and/or rule changes that may be required to achieve them. Key dates during this stage:

- Consultation paper: **13 October 2022**
- Submissions close: **10 November 2022**
- Stage 1 final report: **February 2023**.

Stage 2: will address the implementation of feasible policy options identified in stage one. These dates will be released once the scope of stage 2 is determined.

Related reforms

This Review is one of a suite of recommendations made by the AEMC to Energy Ministers in August 2022 following a request to analyse previous reviews related to financial resilience in the retail sector. These recommendations address process improvements to the RoLR scheme, improve credit support for RoLRs immediately following a RoLR event, examine improvements to the number of registered RoLRs and provide enhancements to the equivalent arrangements for customers in embedded networks.

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