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22 June 2023

### **AEMC Review into the arrangements for failed retailers' electricity and gas contracts: Directions paper**

The Australian Energy Council (the "AEC") welcomes the opportunity to make a submission in response to the AEMC Review into the arrangements for failed retailers' electricity and gas contracts: Directions paper (Directions paper).

The AEC is the peak industry body for electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. AEC members generate and sell energy to over 10 million homes and businesses and are major investors in renewable energy generation. The AEC supports reaching net-zero by 2050 as well as a 55 per cent emissions reduction target by 2035 and is committed to delivering the energy transition for the benefit of consumers.

The AEC would like to acknowledge the effort being employed in this review by the AEMC. We also concur with the AEMC in its decisions to not further consider options and approaches that were in the Consultation Paper. The subject matter of this review is expansive and raises many complex issues beyond energy and gas markets and we look forward to further constructive engagement with the AEMC as the process continues.

Retailing electricity and gas requires responsible and ethical behaviour. Retailer failures tarnish the reputation of the entire industry. This is especially the case when an unethical retailer may decide to have a RoLR event and appears to be driven by the desire for additional profit at the expense of customers and other market participants. This reputational damage is further exacerbated when those involved in retail failures appear to be able to do it with impunity.

As the peak industry body representing electricity and gas retailers, the AEC and its members are committed to a market that treats consumers with respect, behaves ethically and operates with integrity. We fully support the AEMC's desire to explore ways to introduce more accountability for failed retailers.

In the AEC's view the intent of the RoLR arrangements is to:

- Ensure that consumers do not lose supply when a retailer fails;
- Ensure that the RoLR is not disadvantaged from a RoLR event;
- Costs for consumers and the market are kept to minimum;
- Avoid increasing barriers to entry and thereby reducing the scope for competition;
- Avoid creating gaming opportunities for 'failed' retailers; and
- Maintain the integrity and perceptions of the industry.

The RoLR arrangements need to be carefully considered and nuanced to avoid unintended consequences.

## **Electricity retailer failures**

### Question 1: What improvements should be made to the RoLR cost recovery framework?

1. *Should the costs that can be claimed by a designated RoLR be defined specifically? Please specify what costs should be claimable and how they would be identified. Please also comment on whether*

*these costs should be in reference to the DMO for small customers and not available for customers not subject to the DMO?*

- 2. What period after the RoLR event should market costs be able to be recovered by the designated RoLR? Please explain and provide evidence.*
- 3. How beneficial would progressive or estimated payments be to reducing cash flow issues for the designated RoLR? Are these benefits reduced or removed if the market costs that can be claimed are clarified? Please explain and provide evidence.*

Specifying claimable costs would improve RoLR events and there should also be discretion for the AER to grant any additional costs that have not been prescribed. Relevant DMO costs described in the Consultation paper (p.9) is an appropriate starting point for determining costs. 'Green' compliance costs such as having to acquire LGCs should also be included. Because a RoLR event is likely to occur when market conditions are challenging and not reflective of DMO costs, the RoLR needs to have any additional costs to be recoverable. Then it is a matter of ascertaining the difference between the DMO allowances for prudent hedging and 'green' compliance costs and the prevailing market conditions at the time of the event.

Any additional financing costs also need to be included. While it is implicit in the retail margin in the DMO, the impact of receiving a significant number of unprofitable customers may require the RoLR to have to seek immediate financing at a higher interest rate. Increased bad debt provisions also should be included.

For non-DMO customers costs should be based on prevailing market conditions.

The AEC supports a nine-month period for market costs be able to be recovered by the designated RoLR.

Because of the cash flow challenges a RoLR may be exposed to the AEC considers it is imperative that funds to recover costs are passed to the RoLR as soon as possible. The AEC supports estimated costs being paid in the first instance with a true-up later when the exact costs have been determined. The true-up would be determined on a net present value neutral approach employing an appropriate discount rate.

*Question 2: Should we issue the failed retailer with a bill for the costs of its failure?*

- 1. Do you support the AER issuing a bill to the failed retailer for the RoLR cost recovery scheme? If yes, do you also support the registration of a security interest on the Personal Property Securities Register (PPSR) at the time of retailer registration or this law coming into effect?*
- 2. If yes to 1) are there any likely cost of capital implications for retailer entry, expansion and operation? Please explain and provide evidence.*
- 3. Do you anticipate any issues with the timing of the RoLR cost recovery and the insolvency process? If yes, are these issues made better or worse if the AER is registered on the PPSR?*
- 4. Do you agree a minimum threshold should be applied for this mechanism to reduce the potential barriers to entry or expansion? If yes, what should this threshold be?*
- 5. Are there other issues to which the AEMC should have regard to with this option? Please explain and provide evidence.*

The AEC supports the intent of failed retailers being billed for the cost of a RoLR event and acknowledges the work of the AEMC in developing a possible solution. Especially as this may discourage unethical conduct by a failed retailer. However, the AEC does not support the AEMC's proposal to include this liability on the Personal Property Security Register (PPSR) of retailers (ie, making the AER a secured creditor).

Including the AER on the PPSR involves many complexities beyond the electricity market and creates many issues for retailers including:

- all retailers will have to place the AER on their PPSRs;
- creates a barrier to entry for new retailers;
- adversely affects the financing of retailers;
- the costs are likely to outweigh the benefits; and
- the corporate structures of retailers are likely to make billing the entity that has the funds problematic.

Because of the breadth of this issue, the AEC suggests that the AEMC consult with relevant organisations that have expertise in cost recovery from failed entities to obtain further advice as to whether there is a workable alternative. This could include Treasury, ASIC, APRA and the ATO.

Consideration should also be given to other deterrent measures. These could include banning directors and senior executives of failed retailers from re-entering the market for a period of years.

Question 3: What information is necessary for the AER and electricity RoLRs to fulfil their duties, and how should it be collected?

1. *What information should be provided to the AER and designated RoLRs in electricity RoLR events, and how should that information can be most efficiently collected? Please explain and provide evidence.*

The information gathering process should be streamlined to ensure both the AER and the RoLR receive critical information on the failed retailer. This would include historical and forecast load size and shape with the historical data covering a period of one year.

## **Gas retailer failures**

Question 4: Should we change the RoLR gas directions triggers?

1. *Are there any clarifications needed in the current triggers for gas directions?*
2. *If the trigger for gas directions should be expanded to consider issues other than physical supply, what should the criteria be? For example, should the AER have discretion or should there be a defined threshold?*
3. *If the AER has discretion in issuing the direction, what factors should the AER consider? For example, the financial impact to the designated RoLR or current market prices?*
4. *Would expanding the RoLR direction triggers impact a retailer's decisions to enter or exit the market or their ability to obtain gas supply? Please explain and provide evidence.*

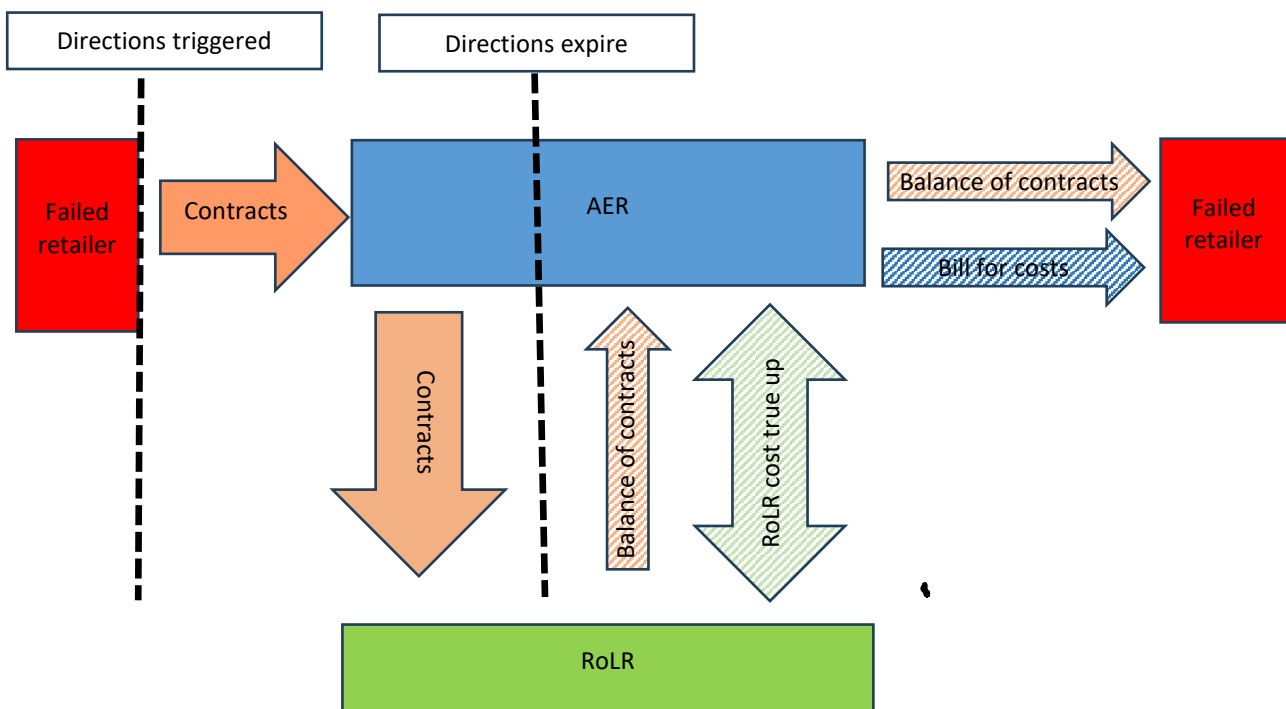
The AEC supports an overhaul of the triggers and directions frameworks. One approach that we believe may simplify and clarify RoLR arrangements:

1. Once a retailer fails this automatically triggers prescribed directions. All the failed retailer's wholesale contracts are automatically directed to the designated RoLR at the discretion of the designated RoLR.
2. There would be no need for a negotiation process as the trigger is automatic. Acceptance of this could be a requirement to hold a retail licence.
3. If there are additional market related financial costs for the RoLR these should be compensated for.
4. Once the directions period finishes:

- a. As proposed for electricity, there is a true up of the actual costs incurred by the RoLR after taking account of any benefits it received from the failed retailer's contracts and any outstanding costs.
- b. If there is any remaining value in the balance of any contracts after the directions expire, these are returned to the RoLR via the AER.
- c. If there are any additional costs the RoLR, the AER can bill these to failed retailer in the first instance.

This suggested approach is set out schematically in Figure 1.

**Figure 1: Failed gas retailer suggested RoLR process**



The AEC believes the RoLR should have the ability to recover any additional costs that are not met through the contract directions process.

The AEC agrees with the AEMC in that these changes will not affect the ability of smaller retailers to obtain contracts because the supplier would be indifferent between the original counterparty and the RoLR because the RoLR is likely to be a more creditworthy counterparty than the failed retailer. However, there is a small possibility that the supplier or RoLR may have existing contracts on foot and the transfer of the contracts to the RoLR may cause one or both parties to breach their risk management policies (eg, counterparty exposure limits) this could be potentially alleviated by the use of credit support facilities the costs of which would be recoverable by the RoLR.

Question 5: Should we increase the length of time RoLR gas directions apply?

1. *Should the RoLR gas directions period be extended from their current level? If yes, how long should directions last? Please explain and provide evidence.*

2. *Do you consider increasing the RoLR gas directions period will influence or increase the cost of gas retailers obtaining finance or other incentives to becoming a retailer? If yes, please explain and provide evidence.*
3. *Would there be benefits in a flexible direction period (e.g. a minimum timeframe with an ability to extend to a specified period)? If so, what criteria should apply to extensions?*

The AEC supports extending the direction period to six months with scope for this to be extended if the AER considers it necessary. It is uncertain whether this will increase the cost of funds for retailers and adversely impact incentives to become a gas retailer. If it does discourage some retailers from entering the market, then this potentially indicates that they should not enter the market due to low financial strength.

*Question 6: Should we introduce negotiation principles?*

1. *Do you support introducing negotiation principles? If yes, what should they include?*
2. *How should compliance with negotiation principles be measured?*
3. *Is the need for negotiation principles reduced or removed with a longer directions period?*

The AEC's response to Question 4 which outlines a suggested RoLR negates the need for any negotiation. Nevertheless, if they are to be retained and reformed, the AEC's view is that there should be requirements on both parties to comply with any negotiating principles as determined by this review.

The AEC believes a longer directions period could reduce the need for negotiation.

*Question 7: Should we remove the negotiation process?*

1. *Do you support removing mandatory negotiations if the RoLR gas directions period is extended?*

The AEC's response to Question 4 which outlines a suggested RoLR negates the need for any negotiation and as such we support removing the mandatory negotiation process.

*Question 8: How should we clarify what happens to contracts that begin or end during directions?*

1. *Should a direction cease when the directed contract expires?*
2. *How should options to extend contracts be treated under the directions framework?*
3. *Should contracts that are due to commence in the directions period be subject to direction?*

A direction should cease when a directed contract expires. The RoLR should have the ability to exercise any extension options in the directed supply contract if it is within the direction period. Contracts due to commence during the directions period should be part of the direction.

*Question 9: Should gas storage contracts be considered in the RoLR gas directions framework?*

1. *Should the gas held in storage be transferred to the RoLR?*
  - a. *If yes, should the RoLR be required to pay the failed retailer for this gas in line with the negotiation principles?*
  - b. *If no, can the storage rights alone be transferred to the RoLR?*
2. *Are there any issues with Victorian gas facilities being included in the RoLR gas directions framework?*

3. *Do you consider there are competition issues that should be mitigated? If yes, what measures would be appropriate?*
4. *Are there any issues with the need to be registered in AEMO's systems to use storage facilities?*

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Storage contracts and all their rights should be covered by the gas directions framework. This may be problematic when the failed retailer has pre-purchased gas in storage. The AEC believes consideration should be given to the RoLR paying the failed retailer for any gas it draws from storage during the directions period.

The AEC is not certain what the price should be but suggest that as the directions framework requires handover of contracts at the contract price, to be consistent any gas in storage should be purchased at the purchase costs plus holding costs including time value of money. This would be consistent with the view that the failed retailer should not be able to profit from their failure.

Question 10. How can the benefits or costs of RoLR events be shared with customers?

1. *How should the benefit of receiving the gas under direction be passed to the impacted customers? Does there need to be separate benefit sharing arrangements for large and small customers?*
2. *Should this requirement be principles based or prescriptive?*
3. *How should compliance with this principle be measured?*
4. *Should gas RoLRs be able to claim wholesale costs associated with RoLR events given there is no DMO for gas? If so, what costs should a RoLR be reasonably able to claim and over what time frame?*

The AEC supports a principles-based approach for sharing any benefits that accrue to a RoLR. Under this approach the RoLR would advise the AER as to how this was conducted.

The AEC is of the view that RoLRs should be able to claim any reasonably incurred costs that exceed any benefits from the contract directions. As noted in the Directions paper, under the current arrangements the RoLR would have to increase its standard retail charge that applies to both its rolled and existing customers to recover any additional costs. While smearing the costs across all its customers limits price impacts at the customer level, the RoLR is operating in a competitive retail market and this will reduce its competitiveness.

Question 11. What information is necessary for the AER and gas RoLRs to fulfil their duties?

1. *What level of customer information should a RoLR receive to efficiently manage their new customers?*
2. *Should there be limits on how the designated RoLR uses certain information? Please explain.*
3. *Who is best placed to hold and then share the relevant customer data with the designated RoLR?*

The AEC supports both the AER and the RoLR having the same granularity of information as described in our response to Question 3. The RoLR's use of this information should be subject to same rules and laws that apply to its existing customers' data. The AER would appear to be logical party to obtain and then share the data with the RoLR.

**Declaration of a gas market administered pricing period following a RoLR event**

While this topic is not in the Directions Paper, the AEC believes it is an issue that should be considered as part of the Review. Under NGR 428 (1) (d), a RoLR event requires AEMO to apply an administered price cap (APC) in the STTMs. Similar provisions govern the DWGM as well. There are further provisions that are applied to determine if it is a minor or major RoLR event. In the case of the former to administered price period (APP) is 15 business days and 20 for the latter.

It is difficult to ascertain what the purpose of this rule and provisions is. To the AEC there is no logical reason for a RoLR event to initiate 15-20 days of APP. For example, a small retailer fails when the STTMs and DWGM are trading at around \$25/GJ then 15 days of APP ensue. These arrangements appear to be counterintuitive and wholly unnecessary because if the markets are turbulent and reaching high prices, the CPT will eventually be reached, and an APP would commence. In fact, the demonstrated inefficient market outcomes associated with the declaration of a RoLR event APP may result in the CPT being exceeded where absent this the CPT may not be exceeded. The AEC notes that no similar provision exists in the NEM for AEMO to automatically declare an APP following a RoLR event. We submit that whereas RoLR events have occurred in the NEM with little if any market inefficiencies or the requirement for AEMO market intervention being observed, the same is not true for the gas markets RoLR events during May and June 2022.<sup>1</sup>

Any questions about this submission should be addressed to the writers, by e-mail to [Peter.brook@energycouncil.com.au](mailto:Peter.brook@energycouncil.com.au) or by telephone on (03) 9205 3103.

Yours sincerely,

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<sup>1</sup> AEMO Quarterly Energy Dynamics Q2 2022 Report – Section 2.1.2 page 42