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Ms Sam Markham
Project Leader
Australian Energy Market Commission
Level 15
60 Castlereagh Street
Sydney NSW 2000

Submitted electronically: sam.markham@aemc.gov.au

Dear Ms Markham

Re: Directions paper - Review into the arrangements for failed retailers' electricity and gas contracts (RPR0016)

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to respond to the Australian Energy Market Commission's (the Commission's) directions paper for its review into the arrangements for failed retailers' electricity and gas contracts. Our comments in this submission are limited to the Commission's proposals for electricity and its discussion of retailer behaviour as the Australian Energy Council's submission to this consultation are consistent with our views on the gas proposals.

This review is timely and important, given the events of 2022 that resulted in an unprecedented number of retailer failures. The energy crisis tested the effectiveness of current Retailer of Last Resort (RoLR) arrangements and as the Commission notes, revealed some areas for improvement even if the combination of circumstances was unique.

The Commission has identified the need to balance a number of potentially competing issues when considering reforms to the current framework. It is important to minimise the costs to consumers of RoLR events as far as possible but RoLRs must be able to recover all reasonable costs. The latter is a key contributor to broader NEM resilience as it could influence other retailers' decision to register as a RoLR, particularly when electricity prices are regulated.

The Commission should also consider the causes of RoLR events. They may result from inadequate hedging arrangements that leave a retailer short in a rising market. Alternatively, failure could occur following the significant degradation or failure of generation capacity owned by that retailer or the fuel supply chain related to that capacity. In all instances, RoLR events are highly likely to coincide with a sustained period of high wholesale prices. This means the RoLR's

exposure would be potentially very large if it is required to take on a share of unanticipated customers from a failed entity. The RoLR framework must be sufficiently rigorous to account for these situations (although the failure of a Tier 1 retailer would probably necessitate a more significant market intervention).

RoLR cost recovery scheme

We agree that the National Energy Retail Law grants the Australian Energy Regulator (AER) some discretion about whether a retailer should bear some of the costs associated with being appointed as a ROLR, and what types of costs are considered reasonable. Therefore, we would support more clarity and certainty about the prudent costs that RoLRs can recover and the associated timeframe. This could be achieved with a more explicit set of principles in the RoLR Guideline.

An obvious reference point is the various components of the Default Market Offer (DMO) for small consumers. The level of the AER's DMO determination in any particular year is highly unlikely to represent the actual costs that a RoLR incurs. This includes additional load for an unanticipated volume of consumers, to meet obligations under environmental schemes, and the costs necessary to continue to provide a reasonable level of service to new and existing customers.

For example, there will be a far greater reliance on spot market purchases to cover unanticipated load than is assumed in the AER's wholesale methodology. Therefore, it is reasonable that the RoLR can claim the cumulative difference between the wholesale energy cost applicable to the relevant DMO and spot prices on the wholesale energy portion of the customer load. The use of prevailing spot prices is simple and transparent. Similarly, the RoLR should be compensated for any demonstrated shortfall penalty or large-scale generation certificates (LGC) procurement losses based on the shortfall charge or LGC purchases that cost more than the DMO environmental cost allowance.

The Commission should also consider the inclusion of an incremental contribution to retail operating costs. As noted, the RoLR will need to offer a reasonable level of service to new customers, while avoiding the degradation of service to existing customers. However, it may encounter capacity constraints (e.g. for billing systems, data management and telephony) if the number of new customers is large. There is also considerable uncertainty about the credit profile of these new customers and a prudent retailer would provision for a relatively high bad debt allowance (i.e. higher than that assumed in the DMO). The RoLR cannot assess the creditworthiness of these consumers and from the consumers' perspective, they are entering into a contract with a retailer that they have not chosen.

A further issue is cashflow, noting the lag between weekly settlements with AEMO for a retailer's wholesale purchases and customers paying their bills. The RoLR should be able to recover any additional financing costs and prudential cover that the absorption of new customers might generate. The directions paper suggests two options to address cashflow issues and our preference is for a RoLR to be able to make and receive multiple cost recovery claims over the course of the RoLR event, rather than one cost recovery claim with a true-up at some future point. If the Commission did decide to use a true-up, it should also consider providing a statutory indemnity in favour of the RoLR so it can potentially access additional funding.

Recovery of costs from failed retailers

While we support the principle of recovering costs from failed retailers, we do not support the Commission's suggestion to make the AER a secured creditor by requiring retailers to provide an 'all assets security interest' on their assets in favour of the AER. It is difficult to see how this could materially increase the funds available to the AER following retailer failure, given where it would still sit relative to other creditors.

Furthermore, we are confident that any benefit would be outweighed by the negative consequences for retailer funding, and for competition, innovation and expansion. This impact would fall disproportionately on smaller retailers and discourage new entry. The Commission acknowledges these risks, particularly in terms of cost of capital and market entry, and this needs to be explored further. The AER has other mechanisms under the current authorisation framework, such as seeking data from retailers and scrutiny of applications for new authorisations (and the relevant officers in those new applicants) that seem more reasonable at this point.

We also welcome the Commission's acknowledgement of the challenges involved in transferring contracts from a failed retailer to a RoLR and the creation of a matchmaking service. This was a key focus of our submission to the Commission's initial consultation in 2022 and we appreciate its detailed analysis of the problems it would create and its decision not to proceed with the proposal.

Retailer behaviour in volatile conditions

While there were some instances of poor retailer conduct during 2022, we agree with the Commission's conclusion that they were not widespread and that sufficient protections are already in place through the National Energy Retail Rules and Australian Consumer Law. There is significant risk of unintended consequences (particularly in terms of a negative impact on competition) of additional limitations of reasonable commercial activities. In particular, we would oppose additional controls on the purchase and sale of hedging contracts.

However, we agree with the Commission that the Australian Competition and Consumer Commission and AER should continue to monitor the market to identify the precise nature and extent of any emerging problem and whether it is sustained. They can then develop a targeted and proportionate response.

The Commission suggests there might be some value in an obligation on retailers to notify consumers of their standing offer. We think this is redundant in light of explicit informed consent and other obligations, and is a second best measure. We are strongly committed to competitive retail markets as they deliver the best outcomes for consumers, including efficient prices. This is also reflected in the DMO's policy objectives. Our preference is for consumers to participate in competitive markets with confidence and choose a market offer that best reflects their needs and circumstances, rather than passively selecting a standing offer. As the Commission notes, a competitive market will produce market offers that are lower than the DMO (even if a consumer has to switch retailers to access them), provided it is set in line with its policy objectives.

We also note the Commission's suggestion that the AER should have the flexibility to amend the DMO within a determination period. This needs to be considered very carefully as stability and predictability are important elements of a framework for the regulation of retail prices. Retailers must have confidence that they can recover reasonable costs over an extended period so any framework that allows for intra period adjustments must include careful controls.

About Red and Lumo

We are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, New South Wales, Queensland, South Australia and in the ACT to over 1.2 million customers.

We thank the Commission for the opportunity to comment on its proposal. Should you wish to discuss aspects of this submission or have any further enquiries, please contact me on 0481 013 988.

Yours sincerely

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