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Ms Merryn York
Chair (a/g) - Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By online submission

Dear Ms York

AER Submission – Review of Retailer of Last Resort (RoLR) scheme

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) consultation paper on its review of the RoLR scheme (the consultation paper).

Introductory comments

The AER has managed four RoLR events since 2016. We have learnt a great deal from these events, including about the RoLR framework's deficiencies and limitations. The amendments proposed by the AEMC are likely to deliver consumer and market benefits and we largely support them.

We note the limited and expedited nature of the current review and have focussed our comments on the five key consultation issues, which we set out below. However, we believe there are a number of other aspects of the framework that warrant a broader, more comprehensive review, at the appropriate time. These include the "other issues" identified in the report and issues we have previously raised with the Council of Australian Governments (COAG) Energy Council and the AEMC, listed in **Attachment A** to this letter. These are important and complex matters that need to be considered properly. We welcome further consideration on these issues.

Retail contracts for RoLR customers

The National Energy Retail Law (Retail Law) provides for small customers transferred to a RoLR to automatically be placed on the RoLR's deemed standard retail contract. The AEMC proposes removing this requirement and allowing RoLRs to submit, for the AER's approval, a market offer to be used for RoLR customers.

AER view

The AER agrees that customers should not be penalised for their retailers' failure by being placed on a more expensive contract, particularly when the RoLR (in practice, the incumbent retailers) has more competitive contracts on offer. We therefore support the recommendation.

RoLR cost recovery arrangements

The AEMC proposes amending the existing RoLR cost recovery provisions to give the designated RoLR greater certainty that it can quickly recover the reasonable costs associated with a RoLR event.

AER view

We agree this amendment may reduce the financial uncertainty faced by designated RoLR(s) following the failure of a large retailer and improve their ability to borrow funds to cover their short-term costs. This increased financial certainty may also encourage more retailers to express interest in becoming additional RoLRs.

As we previously observed however, there is a tension between providing certainty of cost recovery and limiting that recovery to only reasonable costs.¹ Any revised cost recovery arrangements should not reduce the commercial incentives on the designated RoLR to minimise its costs. Customers will ultimately bear the risk of their inefficient behaviour through higher prices.

The AEMC recommendation maintains some commercial incentives. For example, a potential RoLR can still waive recovery of some or all of its costs to acquire customers and the AER retains its role in determining whether the costs incurred by the designated RoLR(s) are reasonable. However, we consider that the cost recovery arrangements should preserve the principle in s. 166(7)(c) of the Retail Law that the registered RoLR will itself bear some of the costs, specifically in relation to smaller retailer failure, where the number of transferred customers (and their load) is low relative to the RoLR's pre-existing customer base.

Framework for RoLR designation

The AEMC recommends amending the RoLR scheme to delay the designation of RoLRs by 24 hours to allow a more considered allocation of customers and greater potential for multiple RoLRs. The AEMC also proposes to require the AER to issue a RoLR notice as soon as practicable following a RoLR event. This is a departure from the current provisions whereby the AER must decide whether to issue a RoLR notice as soon as practicable after a RoLR event, however there are no requirements about the timing for when it should issue a RoLR notice.

The AER would maintain its current ability to appoint a designated RoLR before a RoLR event. There would also be no change to the current provision for the default RoLR to be appointed where the AER determines to not designate a RoLR or issue a RoLR notice.

AER view

The AER has previously noted that a major factor in the appointment of additional RoLRs is the length of time the AER has to make the decision.² The more warning we have of an impending RoLR event, the more potential there is for the AER to consider appointing additional RoLRs.

¹ AER submission, AEMC First Draft Report, NEM Financial Market Resilience, 4 June 2013, pp 3-4

² *ibid*, pp 4-5

By delaying the period of time between the RoLR event and the appointment of the designated RoLR the AER is more likely to be able to appoint additional RoLRs (particularly those who have made a non-firm expression of interest in being a RoLR). This has flow on benefits in terms of limiting the likelihood of cascading retailer failures and promoting a more competitive market structure.

However, as we previously noted, the cost of this approach is that the designated RoLRs will inherit an unhedged exposure to the spot price for all energy consumed during this interim period, which could be substantial if the failure occurred during a period of high spot prices. Given this, the AER would generally try to avoid using the extra 24 hours, particularly if the extra 24 hours is unlikely to change who the designated RoLRs will be. Where there is a question over the financial viability of the RoLRs after the RoLR event, the extra 24 hours will enable the AER to undertake more detailed analysis of financial positions with AEMO and the potential RoLRs.

In the event of a larger retailer failure the default RoLR would know early on that they will likely be taking on some or all of the customers. If in this situation the AER had only one firm offer for a small number of customers and was unlikely to get significant interest from other potential additional RoLRs, the AER would likely still designate the default RoLR.

The AER does not support the AEMC's proposal to require the AER to issue RoLR notices as soon as practicable after a RoLR event. In our view there are some circumstances where this may not be advisable. For example, a RoLR event may resolve itself but this may be less likely if a RoLR notice is given. There may be other processes on foot that may result in a better outcome for consumers than a RoLR event, for instance, a trade sale. It may also not be practicable to issue a RoLR notice if doing so will cause issues for reliability and security of supply. Further, there is no need to issue a RoLR notice promptly after a RoLR event if the failed retailer has no customers or because the customers cannot be transferred, as in the case of embedded network retailers. We believe the likelihood of a retailer failure is a matter for judgement and the AER should therefore retain discretion in the timing of RoLR notices.

AEMO credit support arrangements

The AEMC recommends delaying the increase in AEMO credit support requirements for a short time and then ramping up over a transitional period to reduce the risk of financial contagion occurring through the operation of the RoLR scheme.

AER view

As previously submitted, the AER supports the proposed changes to credit support requirements.³ We recognise that the decrease in the amount of collateral held by AEMO over the transitional period raises the possibility that if the designated RoLR collapsed and was unable to pay, then AEMO generators may be short-paid.

However, generators benefit from measures to mitigate the risk of contagion. Currently, if there is cascading retailer failure, generators face a high risk of not being paid. Lessening the chance of cascading retailer failure is therefore lessening the overall risk to generators. On that basis, the AER considers it is appropriate that generators take on some additional risk (through changes to credit support requirements) in the context of improving the RoLR regime.

This amendment allows the designated RoLR to take up its new customers without having to bear the immediate risk or cost of sharply increased credit support requirements, thereby

³ Ibid, p 5

reducing the likelihood of cascading retailer failure. Importantly, this may also encourage more retailers to offer to be additional RoLRs, knowing they would have more time to secure additional credit support. This would increase the potential for multiple RoLRs being appointed and securing better outcomes for consumers.

RoLR plan requirements

The AEMC proposes, at the AER's request, a recommendation to remove the requirement to publish the conduct of each RoLR exercise the AER undertakes, which in practice includes internal RoLR exercises. We consider the proposed amendments do not affect the intent of the RoLR scheme or diminish its protections, and are common-sense.

The AER supports the recommendation.

Other issues for consultation

The consultation paper identifies the following "other issues":

- Appointment of administrator as a trigger for a RoLR event
- RoLR arrangements for embedded networks
- Whether sections of the RoLR scheme could be better placed in the NERR

We agree that these are important issues that warrant further consideration. However, in our assessment these are complex matters that will likely have wider implications. We consider these, and the issues we have identified at **Attachment A**, require full and proper consideration, more than this expedited review process may allow. We welcome the opportunity to discuss them further, at an appropriate time.

Concluding comments

The AER agrees that there are a number of aspects of the RoLR scheme framework that can be improved. We consider the AEMC's review is a good place to start and hope that it will lead to a more comprehensive review at the appropriate time.

Please contact Arek Gulbenkoglou, General Manager (a/g), Consumers & Markets Branch on (03) 9290 1892 if you would like to discuss this submission in more detail.

Yours sincerely

A handwritten signature in blue ink that reads "Jim Cox". The signature is written in a cursive style with a large initial 'J'.

Jim Cox

Deputy Chair

ATTACHMENT A – RoLR framework issues identified by the AER

The AER has previously raised specific concerns about the RoLR framework with the Council of Australian Governments (COAG) Energy Council and the AEMC. In particular:

Requirement to appoint no more than one default RoLR for each electricity connection point

The Retail Law provides that the AER can only appoint one RoLR per connection point for electricity and per distribution network for gas. This is problematic in the case of gas where more than one distributor is connected to the same gas transmission pipeline. There may also be merit in the AER being able to appoint a second-tier retailer as a default RoLR in some instances to help spread the RoLR load, including compulsorily.

Mandatory tendering of the RoLR function

In the AER's experience, with the exception of the 'Big 3' retailers, retailers have shown no interest in registering as additional RoLRs. We have previously recommended either removing the requirement or giving the AER the discretion to call for expressions of interest.

If the RoLR tender process is retained, consideration should be given as to whether AEMO should have a formal role in interpreting and assessing the required data. As the custodian of the data and market systems, AEMO is better placed to undertake that role.

Scope of confidentiality requirements under section 131 of the Retail Law

Section 131 of the Retail Law states that anyone given notice of the risk of a RoLR event must keep the information confidential and no-one, other than the AER and AEMO, may disclose the issue of the notice and the information it contains to their 'marketing staff'. We note that for retailers, marketing staff are generally responsible for managing RoLR related communications and therefore recommend a more pragmatic option is to prohibit the conduct, rather than the specific staff. We also query why the AER would issue a notice to itself (s.131(4)).

Limiting the requirement to appoint a default RoLR for each electricity connection point to directly connected customers supplied by an authorised retailer that is financially responsible for the connection

Section 125 (1) of the Retail Law requires the AER to appoint and register a default RoLR for each electricity connection point. 'Connection point' has the meaning it is given in the National Electricity Rules, which is the agreed point of supply between Network Service Provider(s) and another Registered Participant, Non-Registered Customer or franchise customer. This definition conceivably extends the AER's RoLR appointment obligations beyond the scope of the RoLR scheme. We understand, for example, that there are some registered participants who are supplied by non-retailers under legacy arrangements. Technically, these connection points are covered by the RoLR scheme and require the appointment of a default RoLR.

Clarifying the customers affected by a RoLR event

Section 136(4) of the Retail Law states that RoLR notices must be framed so as to deal with all customers of the failed retailer. This can be problematic if the retailer operates as a single legal entity and has both electricity and gas customers. A retailer that fails in one market does not necessarily fail in the other, as was the case with Go Energy. Accordingly, if a dual fuel retailer fails in one market the RoLR notice should be limited to the affected customers.

While the AER takes a common sense approach in the drafting of RoLR notices, we suggest clarifying this and other ambiguous provisions.⁴

Centrepay issue

Section 141(5) of the Retail Law requires a failed retailer or their insolvency official to cancel any direct debit authorisations with effect on, or from, the customer transfer date. Cancellation of Centrepay or direct debit authorisation with effect from the transfer date can affect payment for customer liabilities accrued before the transfer date. Where a customer has a payment plan for arrears with the failed retailer and makes those payments by direct debit or Centrepay, these arrangements should only be cancelled for liabilities accrued after the transfer date.

Retailers to advise large customers of RoLR arrangements

Section 169 of the Retail Law requires information about RoLR arrangements to be included in small customer contracts. We consider there is merit in requiring retailers to inform all customers, including large customers, of the RoLR arrangements applicable to them.

⁴ For example, section 140(1) of the Retail Law states 'Each person who was a customer of a failed retailer immediately before the transfer date.'