



19 November 2020

Australian Energy Market Commission
GPO Box 2603
SYDNEY NSW 2000

Lodged electronically: aemc@aemc.gov.au

Reference: RPR0015

Dear Sir/Madam

Review of the Retailer of Last Resort Scheme

Origin Energy appreciates the opportunity to provide input into the Australian Energy Market Commission (AEMC) Review of the Retailer of Last Resort (RoLR) Scheme.

We endorse a regulatory framework that minimises, and preferably avoids, financial system instability in the event of a retailer failure. To date, the RoLR scheme has worked effectively for the failure of small retailers. It has been invoked several times without interruption in supply and without wider impacts on the retail market. However, we recognise that given the current environment, a review is prudent to ensure the scheme is capable of withstanding greater stresses.

We agree that it is important to ensure the scheme protects customers in terms of both continuity of supply and the price they pay in a RoLR event. Unlike the previous scheme, standing offer tariffs are now regulated. This provides confidence that in a RoLR event, customers will transfer to a fair price – an efficient safety net. We believe that attempting to impose competitive pricing conditions in a circumstance of retailer failure risks creating unnecessary additional complexity and risk when the concerns of customers transferring to an inefficient price are now largely addressed.

Origin strongly advocates the role and importance of appointing appropriate RoLRs in a timely manner to manage retailer failure events in both the electricity and natural gas sectors. The RoLR retailer performs a unique role in guaranteeing energy supply for consumers whilst also taking on short term financial risks of both managing increased consumer load and seeking payment for energy use. We believe the proposed 24-hour delay in designating RoLR retailers will increase the financial risks in the market. Minimising risks and costs to the RoLR should be a key consideration to the framework.

Further, Origin agrees with the AEMC that RoLR events will be more commercially viable to retailers if there is greater clarity on cost recovery. Greater clarity on costs may incentivise smaller retailers to register with the AER to participate as a RoLR. This is an important element to assist the RoLR scheme function effectively and could diversify and reduce the overall risks for each individual retailer. A clear process and right for cost recovery is a key element to making the framework commercially viable and minimising regulatory intervention.

Alongside this, appropriate mechanisms must be in place to manage credit support requirements when a retailer takes over the customers of a failed retailer subject to a RoLR event. It is our view that the maximum credit limit (MCL) requirements would be better managed by allowing the use of cash to provide guarantee rather than introducing 'grace periods' for payments. We do not believe that allowing a lag for AEMO credit support for a RoLR event will meet the objectives of the Credit Limit Procedures

and prudential standards as it would potentially expose the market to a new RoLR event. This would not be in the interest of consumers nor the industry.

RoLR events are likely to occur in a time of volatile market circumstances and in a compressed timeframe. The compressed timeframes require that the framework is simple and transparent to ensure that customers are appropriately managed to receive continual supply of energy. Effectively managing these elements will assist in customer satisfaction and minimise the costs incurred by industry in managing such an event.

Origin's response to the questions raised in the Consultation Paper are set out below.

QUESTION 1: RETAIL CONTRACTS FOR ROLR CUSTOMERS

- a. Do you agree that removing the requirement for RoLR customers to be placed on standard retail contracts would improve RoLR scheme customer outcomes?
- b. Are there any consequential changes to the RoLR scheme that should be made if this change is made?

The current provisions of the National Energy Retail Law (NERL) state that regardless of whether a small RoLR customer is being supplied on a market contract or a standard retail contract prior to the RoLR event occurring, the small RoLR customer must be transferred onto a RoLR retailer's standard retail contract.

The AEMC has recommended, as part of this review, that the RoLR retailer should submit, for the AER's approval, a market offer to be used for small RoLR customers. The AER would assess the benefits of the market offer against the RoLR's standing terms and conditions and determine which offer is best placed for the RoLR customer.

We question how effective this arrangement would be in practice. It will be extremely difficult for the AER to determine both the value of the product offering to a customer and the tariffs that best suit the entire RoLR customer base. For example, if the AER decides on a market offer that provides a discount for customers with e-billing, monthly billing or pay on time discount, how are customers treated if they do not meet the conditions of the market offer?

This further raises the enforceability of the market offers as they are reliant on explicit informed consent to vary the NECF approved standard terms and conditions. Retailers rely on the customer's explicit informed consent that the customer will abide by the conditions of the contract in order to receive a discount or benefit. A deemed transfer will not provide the consent required to enforce the contract terms as we will not have a record of the individual contract terms. We believe changes would be required to both the NERL and NERR to enforce a RoLR customer to comply with the contract terms of a deemed market offer.

Finally, it is unclear when a RoLR retailer would submit a pricing proposal to the AER for approval. Providing the pricing proposals prior to a RoLR event has shortcomings as the suite of product offerings by a retailer are continually changing and may not be relevant when a RoLR event eventuates. Providing the pricing proposal after the RoLR event is also problematic as it will take time for the AER to approve the prices, system changes need to be implemented and there is a heightened risk that customer then transfers away from the RoLR retailer prior to bill being issued. This leaves the RoLR retailer with unbilled energy and potentially increased levels of bad debt.

It should be noted that there have been significant market changes over the past 12-18 months with the introduction of the default market offer (DMO) and Victorian market offer (VMO). These prices establish an efficient safety net price for standing offer customers, largely addressing the concerns about customers to inefficient higher prices.

Based on the above, we support the continuation of the use of the standing offer price. The standard prices can be applied efficiently and effectively across a wide cross sectoral customer base, significant number of distribution areas and allows retailers to focus on those customers most in need of assistance at the time of the RoLR event. Defaulting customers onto market offers will only increase the complexities of supply arrangements for RoLR customers and increase the timeliness in which bills are issued.

QUESTION 2: ROLR COST RECOVERY ARRANGEMENTS

- a. Do you agree that the proposed changes would improve certainty for retailers around ROLR cost recovery arrangements?
- b. Do you agree that increased certainty over cost recovery would provide an incentive for an increased number of retailers to volunteer to become RoLRs?

The NERL includes a process for RoLRs to apply to the AER for cost recovery of the costs it incurs in preparing and participating in a RoLR event. The AER's statement of approach states that for a smaller retailer failure "*the AER considers customers of the failed retailer should pay a great portion of the costs. They can be achieved through a cost recovery scheme comprising an upfront fee and the distributor payment determination*"¹. For a larger retailer failure, the AER may opt for cost recovery to be managed through network tariffs where the costs associated with the failure is spread across all customers and networks.

The AEMC raises concerns that the delay in deciding the means of cost recovery could lead to financial distress for a RoLR and have a cascading effect on the RoLR retailer struggling to meet financial requirements. Therefore, RoLR cost recovery should be solely recovered through network charges and an application for cost recovery should be made within three months of notification of the RoLR event.

Distribution costs recovery

Origin is supportive of a distribution network tariff variation to recover RoLR cost. This cost recovery mechanism will:

- provide greater certainty of cost recovery as it does not rely on upfront fees or retailer tariff variations;
- reflects the financial risks that a retailer of last resort role undertakes when being designated as a RoLR;
- less of a price impact to customers as the costs are spread across a wider customer base; and
- ensures competitive neutrality in the retailer market.

While we support a network cost recovery, it is unclear which cost recovery mechanism will be utilised. We believe the most appropriate cost recover mechanism would be to treat RoLR costs similar to how 'jurisdictional scheme' costs are treated. That is, the network would recover the costs in respect of that RoLR event network in each applicable regulatory year of the regulatory control period by including these costs in their annual pricing proposal. Where the costs were not fully recovered, adjustments could be made to subsequent pricing proposals to account for any over or under recovery. Further it would appropriate that costs be recovered on a per customer basis across the networks.

Treating RoLR costs in this manner would remove the requirements for materiality thresholds that typically apply to cost pass-throughs and would provide greater certainty to retailers of cost recovery.

¹ AER Retailer of Last Resort Statement of Approach, November 2011, p 21.

An alternative option to ease costs pressure of a RoLR retailer would be for the distributor to ease credit terms for the payment of network bills or delay the payment terms for customer of the failed retailer now serviced by a RoLR retailers.

Time period for making application for costs

The AEMC proposes to specify a three-month period from the date of the RoLR event during which a RoLR cost recovery application could be made. This relates to administration costs, additional energy costs and financing costs.

While we support placing a time limit on the recovery of costs, we believe a three-month time period is too short. We consider a six-nine month timeframe is a more reasonable time – this would not preclude a RoLR retailer submitting their costs earlier if they felt they could provide the costs. There will be circumstances where material costs may not be identified until after a first round of retailer billing which may not occur until three months after a retailer failure. This could be due to poor billing practices of the failed retailer or data quality issue of a failed retailer.

This also applies to wholesale costs. The impact of the wholesale market, the availability of settlement data and other sources of uncertainty suggests to us that any time period should be no less than six months.

We support the AEMC proposal to provide the AER discretion to allow for cost recovery beyond a specified time period where the retailer can provide evidence of the costs incurred.

QUESTION 3: FRAMEWORK FOR ROLR DESIGNATION

- a. Do you agree that it would be beneficial to delay RoLR designation?
- b. If so, in implementing the recommendation to delay designation of the RoLR, what is the best approach and timing of the AER's notices to communicate the RoLR event and designated RoLR to market participants and consumers?

When a RoLR event is triggered, a designated RoLR is appointed for each electricity or gas connection point. The pre-designated RoLRs are taken to be appointed unless AEMO notifies other retailers before the transfer date. Generally, there is little time between notice and the RoLR event occurring and the AER has little time to consider other retailers. The AEMC is proposing to amend the NERL to increase the time allowed for the AER to advise AEMO of the designated RoLRs for up to 24 hours after the RoLR event.

While it is only a minor delay, we believe it will nevertheless significantly increase the risks of taking on the role of RoLR retailer. RoLR events are most likely to occur at times of high wholesale prices and delaying notice of RoLR obligations increases wholesale hedging liabilities for 24 hours. This may result in higher costs for the additional load and add additional pressures on smaller retailers who's financial RoLR position changes between the time it expresses interest in being a RoLR and being designated as a RoLR.

The delay in designating RoLR retailers also delays customer communications as to the terms and conditions of supply, increases anxiety for consumers as to who will be supplying them and delays the transfer of customer details for customer management purposes. The aim of the RoLR scheme is to provide certainty to both customers and industry and it seems delaying appointing RoLRs will cause greater confusion than certainty to the market.

We note that the RoLR Guidelines require retailers registered as additional RoLRs with firm offers to confirm their offers with the AER every three months using the renewal form template². We feel, given current market circumstances with the pandemic, that it would be better for the AER to utilise this documented procedure of maintaining retailer interest for additional RoLRs instead of delaying the designation of RoLR retailers.

QUESTION 4: AEMO CREDIT SUPPORT REQUIREMENTS

- a. Do you agree that the current AEMO credit support requirements heighten the risk of financial contagion occurring through operation of the RoLR scheme?
- b. Do you agree that AEMO's credit support requirements should be, as proposed, amended through a rule change request to address this issue?

Currently a participant must provide an amount of credit support to AEMO which is at least equal to its maximum credit limit (MCL). AEMO can change the prudential settings with one business day's notice. Any changes that result in an increased MCL require the participant to increase its level of credit support. The AEMC notes, through the RoLR review, that if the increase in credit support is substantial, it is possible that an otherwise solvent retailer could fail to meet its obligations.

The AEMC is thus recommending that a RoLR retailer be provided one week 'period of grace' following a RoLR event, following which the required credit support would be ramped up in increments over a period of 4 weeks until it reaches the level that reflects the additional load increase from the RoLR event.

Origin believes that if a large retailer was to go insolvent, or suspended from the wholesale market, there is systemic risk to the system as no retailer would be able to take on a MCL the size of large in such a short period of time.

In periods of market stress, which is a likely occurrence of a RoLR event, a retailer would likely have little headroom to provide additional credit support to AEMO to satisfy their increased MCL levels. As a general statement, over summer, a retailer may have periods where they actively manage their prudential exposures using bank guarantees and cash. An issue during a RoLR event is that cash cannot be used to satisfy a retailer's MCL level. A retailer can only use cash to lodge security deposits to reduce accrued outstanding amounts and, in these cases, a retailer would be able to continue to purchase from the wholesale market and stay compliant.

Origin believes that the best way to cater for increased MCL levels as part of a RoLR event is to allow the use of cash to secure up to a new MCL level while a bank guarantee is being arranged. In practice, banks need a number of days to arrange for a bank guarantee. Origin believe that this could be achieved by AEMO amending section 3.1 in the Credit Limit Procedures for a RoLR event to include the provision to allow cash to secure the MCL for a short period³.

² Clause 4.3 Retailer of Last Resort Guidelines.

³ National Electricity Market Credit Limit Procedures.

QUESTION 5: ROLR PLAN REQUIREMENTS

a. Do stakeholders agree that this minor amendment would provide the AER with appropriate flexibility?

This proposed amendment appears reasonable.

QUESTION 6: APPOINTMENT OF ADMINISTRATOR AS A TRIGGER FOR A ROLR EVENT

- a. Is the appointment of an administrator an appropriate trigger for a RoLR event?
- b. Would the appointment of an administrator be more appropriate to trigger a monitoring process by the AER? If so:
- what type of reporting from the administrator to the AER would be appropriate?
 - what are some alternative triggers for a RoLR event following the appointment of an administrator?

The principle objective of the RoLR scheme is to ensure security and continuity of supply. To the extent that the AER seeks to apply a monitoring function in the RoLR scheme, it must not comprise the objective of ensuring financial system security.

QUESTION 7: ROLR ARRANGEMENTS FOR EMBEDDED NETWORKS

- a. Should embedded networks have some form of RoLR arrangements?
- b. If yes, what solution is appropriate to provide embedded network customers with RoLR arrangements?

Embedded network arrangements are complex and require consideration in terms of the flow on impacts of a RoLR event. The embedded network framework is undergoing change with the implementation of recommendations from the AEMC's "Updating the Regulatory Framework for Embedded Networks – Final Report"⁴. The recommendations recognise that embedded networks require consumer protections but there are complexities in that they all do not have billing capabilities and forcing embedded network owners to comply with certain obligations may not be relevant. Consideration needs to be given to the implementation of the recommendations from this report in developing a relevant RoLR embedded network framework.

It is noted that the AEMC has suggested an arrangement for dealing with RoLR customers in an embedded network. This includes the AER appointing a RoLR for the distribution network to which the embedded network is connected (similar to the experience for on-market customers). This seems like a straightforward approach and provides clarity to a customer base as to who their allocated retailer of last resort. However, a consideration with this approach is that not all default retailers for a distribution area have embedded network billing and customer management capabilities. We support this option being explored further.

Another option raised by the AEMC is for the AER's exempt sellers guidelines to be updated to require exempt sellers to make arrangements with an authorised retailer or exempt seller to be the default RoLR for their network in the event of failure. The nominated RoLR could be reported to the AER and required to take on the customers in the event of the exempt seller failure. This would appear to be a cumbersome, complex and high risk probability that the exempt seller did not understand or know the default retailer RoLR arrangements. It also requires than an exempt seller (who may be a retailer) to nominate another retailer to take on customers in the event of a retailer failure. This would seem to be a strange arrangement for a competitive energy market.

⁴ AEMC, Updating the Regulatory Frameworks for Embedded Networks, June 2019

If you have any questions regarding this submission, please contact Caroline Brumby in the first instance on (07) 3867 0863 or caroline.brumby@originenergy.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sean Greenup', with a large, stylized flourish at the end.

Sean Greenup
Group Manager Regulatory Policy