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Manager, MCE Secretariat,
Department of Resources, Energy and Tourism
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Dear Ms Pattinson,

The Australian Energy Regulator (AER) welcomes the opportunity to comment on the National Retailer of Last Resort (RoLR) framework recommendations contained in the NERA Economic Consulting and Allens Arthur Robinson (NERA/AAR) paper.

The AER supports the broad objectives and principles underpinning the proposed framework. The AER welcomes a set of national arrangements covering both electricity and gas, noting the likelihood that any retailer failure is likely to occur across a number of jurisdictions. The NERA/AAR paper represents a substantial step towards achieving a set of nationally-consistent arrangements.

Key points on the proposed framework

The NERA/AAR paper highlights, however, that there are still a number of areas associated with RoLR that need to be addressed before the RoLR framework is complete. In particular, further consideration should be given to the following areas:

- **Emergency measures** — NERA/AAR consider potential “emergency measures” but do not explore the potential types of emergency measures in detail, or how such measures would interact with AEMO functions, particularly prudential requirements. Furthermore, it appears that the only criteria identified for implementing “emergency measures” is the risk of cascading failure. The risk of cascading failure is an important consideration, however, the circumstances that justify adopting emergency measures (either as an alternative to RoLR or in addition to RoLR) may be varied and are difficult to predict in advance. To maintain a flexible and event-specific approach, the discretion to enact emergency measures should be broad and not limited to one criterion.
- **Gas Shippers** — NERA/AAR note that the RoLR frameworks in the United Kingdom and Ireland include provisions for the failure of gas shippers but do not consider gas shipper failure in the Australian context. Further consideration should be given to the need for Australian gas shipper failure provisions.

The AER has some key concerns about the following NERA/AAR recommendations:

- RoLR event fees — the AER disagrees with the recommendation for the AER to set specific RoLR fees for each local retail area in each jurisdiction. Given the event-dependant nature of RoLR fees, an ex-post recovery process is preferred.
- Opt-out — the AER supports the development of a fully national scheme that applies to both the electricity and gas sectors. However, further consideration should be given to issues surrounding the ability for jurisdictions to opt out of the RoLR scheme.
- Early disclosure of information— while it may be necessary to “sound out” pre-registered RoLRs if a RoLR event seems likely or imminent, the AER is concerned about any unintended consequences of it “sounding out” pre-registered RoLRs. The AER therefore recommends that it be granted statutory immunity for its conduct in releasing information prior to a RoLR event.

Specific comments on NERA/AAR proposals

A. Objectives specified

Two issues arise from the objectives proposed in the draft report.

Objective 1: *“To ensure that all customers of the failed retailer continue to be supplied with energy”*

In an earlier submission to the Retail Policy Working Group¹ the AER considered that “services” should be added to the end of this objective to better capture all those things which should be provided for in terms of customer continuity — metering, billing, transfers as well as the physical receipt of energy.

Objective 5: *“To maintain continuity of payments to suppliers of distribution services, metering and data management agents and other ancillary services related to the supply and sale of energy.”*

For completeness this objective should refer to generators and producers explicitly rather than inferring them from objective 2.

B. Recommended coverage

1. Opt-out

NERA / AAR propose a fully national RoLR scheme that addresses retailer failure in both the electricity and gas markets but makes provision for jurisdictions to opt out of the national framework for gas arrangements. The AER supports the notion of a national scheme as a national approach has the potential to deal with a retailer failure across jurisdictions (and for both electricity and gas) in a consistent manner. That said, the AER recognises that there may be circumstances where no alternative gas retailer could be appointed in a RoLR event. The Rules should therefore identify the types of circumstances in which jurisdictions would be

¹ AER, *Submission to Consultation Paper prepared by Allens Arthur Robinson for the Retail Policy Working Group on the National Framework for Distribution and Regulation*, 23 July 2007

unable (rather than unwilling) to participate in the gas RoLR scheme. The AER recommends that the decision to opt out should rest with the jurisdictions (as opposed to being subject to derogations or AER approval). There should be a notification process for opt out decisions so that the AER is aware, well in advance, of any situation where a jurisdiction has opted out. The AER recommends that there be restraints on when jurisdictions may opt out, for example, opt out should not be permitted during a RoLR event. Consideration should be given to the possibility of a jurisdiction opting out for a single retailer (for example, a large incumbent retailer), but not for smaller retailers. Furthermore, consideration should be given to possible problems that may arise in situations where a market player operates in two or more jurisdictions, one of which has opted out and one of which has not opted out.

2. Gas Shippers

NERA/AAR note that under the United Kingdom and Ireland RoLR framework gas suppliers must continue to facilitate supply to premises for which they are a shipper if their licence is revoked. The AER suggests that gas shipper failure is also relevant in the Australian context and could occur in a number of ways:

- a. a shipper fails and it is a retailer for all the gas it ships
- b. a shipper fails and it is a retailer for some of the gas it ships, but other retailers also contract for some of the shipper's gas
- c. a shipper with no retail operations fails.

The AER is concerned with the adequacy of the proposed RoLR framework for ensuring continuity of supply in these types of scenarios. The AER recommends that further consideration should be given to these scenarios through the Retail Policy Working Group.

C. RoLR appointment process

1. RoLR by tender appointment

The AER considers a RoLR by tender process has some real benefits and is pleased to see it included in the proposed RoLR framework. These benefits include:

- the ability of retailers to determine for themselves whether they are in a position to bid for customers and the terms on which they can accept customers, e.g whether they can waive RoLR fees;
- avoiding having to impose RoLR responsibilities on any retailer as a mandatory RoLR process necessarily requires;
- avoiding having to assess RoLR costs in advance — the Victorian ESC May 2008 decision highlights the varied industry/regulator views on an appropriate calculation methodology;
- promotion of competition and the consequent benefits for retailers and consumers, and
- simplifying outcomes from an event management perspective.²

² NERA highlight the capacity for the AER to appoint one voluntary RoLR where over a number of jurisdictions and local retail areas customers are affected by a retailer's failure. This outcome is in contrast to potential outcomes under the mandatory appointment process where customers could be spread across many default RoLRs (for example, when Energy One left the market in 2007, customers were distributed to

The AER has some further comments on the measures recommended by NERA/AAR to support the identification of a voluntary RoLR:

- Information dissemination prior to a RoLR event: The AER considers that, in order to better facilitate a tender process, some aggregated information should be released to participating RoLRs prior to the formal trigger of the RoLR event occurring. The power of the AER to release information prior to the formal RoLR trigger should be statutorily supported and subject to statutory immunity. The AER notes that the extent of the information which should be released has yet to be considered but supports the United Kingdom model where the regulator has developed information templates following consultation.
- Pre-registration: Pre-registration of potential voluntary RoLRs is an important aspect of the framework. The process permits identification and narrowing of the potential RoLR field and will also assist in identifying the parties who will need to demonstrate system capacities to act as a RoLR. NERA/AAR recommend that in order to pre-register, RoLRs would have to demonstrate systems are in place (i.e. to handle customer transfers). These systems would be subject to ongoing audits. The AER assumes that it will have sufficient discretion to determine the level of system capability that needs to be established for pre-registration/auditing. As an example, small registered retailers will presumably only have to build systems to accommodate the amount of customer transfers that they would bid for should another retailer fail.
- The AER notes and supports the consultants' recommendation that the AER's decision on a voluntary RoLR be subject to statutory immunity.

2. Mandatory RoLR appointment

The AER recognises the necessity for a mandatory scheme to support customer energy service continuity and the integrity of the market, as it cannot be assumed that a voluntary RoLR will come forward on each occasion.

The AER makes the following specific comment on the mandatory scheme proposed:

- The AER recommends the occurrence of a major merger/acquisition should be an additional trigger for a review of default RoLR classifications.
- The AER notes and supports the consultants' recommendation that the AER's decision on a mandatory RoLR appointment be subject to statutory immunity.

3. No RoLR decision / Other Emergency Intervention

The AER notes the flexibility the framework provides for the AER to decide that no RoLR solution is possible. The outcomes under this scenario will obviously depend upon the suitability and availability of alternative emergency intervention powers.

approximately 10 separate retailers). The AER considers that event management in the first scenario would be easier.

Emergency intervention and no RoLR

The AER urges the RPWG to give further consideration to the types of emergency measures that may be implemented and the ways in which these emergency measures would interact with AEMO functions. For example, it may be the case that the Government and administrator find a solution that enables the struggling company to continue retailing. However, this may raise problems with AEMO's functions and responsibilities for the continued functioning of the entire market, particularly AEMO's responsibilities to ensure players satisfy prudential requirements.

NERA/AAR propose that the AER would, in assessing a RoLR event, decide whether it can appoint RoLRs in a way that avoids the risk of cascading failure(s) in the market. If a risk of cascading failure(s) is found to exist, the AER understands it is to advise jurisdictions that emergency measures other than RoLR should be invoked.

The AER suggests that NERA/AAR's criteria could more broadly refer to the AER considering the likely cost/benefit of appointing a RoLR against the cost/benefit of using other emergency measures. Other criteria might also be included. However, the AER recommends that any list of relevant criteria should be non-exhaustive and that the AER should be able to consider "any other relevant material". It would be difficult to formulate precise criteria in advance, given the very wide range of potential circumstances that could give rise to a failure.

The AER notes the consultants' recommendations for continuous information disclosure and the ongoing requirement for the AER to monitor the systems capabilities of default and pre-registered RoLRs.

The AER agrees that advance notice that a retailer is experiencing financial difficulties will help assist in the efficient management of RoLR events. However, the AER is not a prudential regulator and is unable to oversee the financial well-being of energy retailers. Any continuous information disclosure requirements should be designed for the sole purpose of enabling the AER to receive advance notice that an energy retailer is experiencing financial difficulties that may trigger a RoLR event. It should not be necessary for all retailers to continuously report to the AER on their financial status. A disclosure obligation should only arise where a retailer experiences financial difficulties that may prevent them from meeting their supply obligations to customers.

Price caps

NERA/AAR appear not to support the use of administered price caps in conjunction with a RoLR appointment. NERA/AAR note that while such a scheme may mitigate the risk of cascading failures, it may have unintended consequences in the market resulting in, for example, profit losses for generators and upstream gas suppliers.

The AER supports including the option of administered price caps at the time of a RoLR event. It understands, for example, that Victorian gas industry participants have agreed to a rule whereby upon suspension of a retailer, prices in the market may be capped at the

administered price cap for 15 business days unless all three RoLRs agree otherwise.³ Retailers have indicated the desirability of protections from the spot market while they endeavour to quickly renegotiate gas market contracts to cover their new loads.

The AER does not believe, however, that an administered price cap should always be put in place. A RoLR event that involves a “small” retailer failure (e.g. less than 5,000 customers) would clearly not justify such a degree of market intervention.

The AER further recommends that the decision on whether to have an administered price cap should not lie with the RoLR(s). As noted by NERA/AAR, the imposition of an administered price cap has impacts on other participants in the market, specifically generators and producers through potential lost profit opportunities. Therefore the AER considers an independent body should, at the time of a RoLR event, oversee how long (if at all) an administered price cap is imposed. The AER anticipates that if most retailer failures are small, as has been the case in the United Kingdom, an administered price cap would not be required.

D. RoLR fee recovery

NERA/AAR recommend allowing the RoLR to charge pre-approved up-front fees and for the RoLR to later be able to make ex-post claims to the Regulator for additional material, efficient costs.

Whether some or all costs should be paid by the failed retailer’s customers or smeared is a significant policy matter with broader potential competition impacts.

From an economic regulatory perspective the AER wishes to raise some practical issues with the consultants’ proposals based on its regulatory experiences and its understanding of other regulators’ experiences:

- a decision on RoLR fees in Victoria finalised in May 2008 for electricity and gas was contentious and lengthy
- a decision on RoLR fees for all jurisdictions would likely also involve numerous lengthy consultations
- regular reviews as envisaged by NERA/AAR would require substantial resourcing by industry and the regulator depending on how often reviews were undertaken.

The AER considers there would be substantial industry-wide costs involved with calculating specific RoLR fees across each local retail area and then to regularly review these fees. The AER does not see the benefit for separate RoLR fee decisions for each local retail area, particularly given that:

- costs can only ever be roughly estimated pre-event;
- RoLR events may occur infrequently; and
- even if a RoLR event occurs, fees may be waived.

³ The AER understands that there is no similar trigger for an administered price cap on the occurrence of a RoLR event in the National Electricity Market. However, an administrative price cap will be applied to the market where high pool prices persist over a specified period.

The AER therefore considers an ex-post cost recovery would be the most cost-efficient approach to ascertain event-specific costs. Any ex-post recovery should be in the nature of a pass-through and account for both the RoLR's administrative and wholesale costs⁴ and the [likely] benefits of taking on customers (future revenue stream) after the RoLR event.

E. Bankruptcy triggers

NERA/AAR note that national electricity market legislation gives the National Electricity Market Management Company (NEMMCO) the discretion to suspend a retailer from the market when it is in administration. NERA/AAR raise the possibility of administrators being permitted to trade on for a period to allow more time to organise a trade sale. In this context, the potential role that market operators (or the AER) would have to play in approving such a process is noted. In the end, NERA/AAR consider this issue to be outside the scope of the review.

The AER suggests that if this discretion is retained within the National Electricity Market (NEM) framework, then a similar discretion should exist across all jurisdictions and for both gas and electricity. This would avoid a situation in which an administrator of an electricity business was allowed to continue trading in the NEM, but not in another jurisdiction, resulting in that retailer's customers having to be transferred in that particular jurisdiction (if no similar discretion exists).

F. RoLR tariff

NERA/AAR recommend that in the event of a default RoLR failing, the applicable tariff for small customers would be the default RoLR's tariff for that local retailer area. The AER queries why it should not be the tariff of the retailer that is actually appointed as the RoLR. Presumably the tariff of the appointed RoLR would reflect their own costs most accurately and should be the tariff that is utilised, rather than the tariff of the default RoLR. It is possible that the default retailer's tariffs are the reason for, or a contributing factor in, that retailer's failure.

G. "In flight" transfers

The consultants recommend that transfers-in-progress both to and away from the failing retailer should be cancelled as soon as a RoLR event is triggered. The AER accepts the rationale for cancelling transfers to the failing retailer, but not transfers away from the failing retailer. One of the reasons the consultants give for the proposal is that this will reduce the workload of the market operator. However, the market operator will still need to deal with the everyday transfers of customers to and from other retailers in the market regardless of a RoLR event. It is unlikely then, that managing transfers away from the failing retailer will place significantly more strain on the market operator's systems. The AER notes that in Victoria transfers away from a failing retailer are not only permitted, but accelerated. It seems unnecessary and burdensome to require the customer and receiving retailer to reinitiate the transfer process if there is a RoLR event. The AER therefore does not support this proposal.

H. Thresholds for small customers

⁴ Our understanding is that anticipated wholesale costs would be included in the up-front fees. However, the paper is inconsistent on this matter: the discussion at page 46 suggests that the up-front RoLR fee is not to include wholesale market costs.

The paper suggests that RoLR tariffs may differ only with respect to large and small customers, and that the definition of large and small customers is determined by the respective jurisdictions. In fact, a common definition of small/large customers will be adopted under the national energy customer framework.

I. Voluntary invocation of RoLR event: penalties for contrary behaviour

The AER notes the consultants' view that voluntary invocation of a RoLR event (as opposed to a managed exit from the market, for example in the case of a retailer being bought by another retailer or internal business restructuring requiring a licence surrender) cannot be prevented. The AER agrees with this statement, based on the current Australian energy market design, but is keen to discourage such practices.⁵ The consultants propose a range of measures that may act as disincentives for retailers, such as the AER revoking the retailer's licence, and the AER taking into account voluntary RoLR invocation in the retailer's reapplication for a licence. The consultants also mention the possibility of penalties for contrary behaviour. The AER agrees, in principle, with this suggestion, but suggests that the types of behaviour that might attract penalties need to be considered further (eg failure to keep the AER informed of the retailer's financial position).

Thank you for the opportunity to comment on this consultation paper. I look forward to ongoing involvement in the consultation.



Michelle Groves
CEO
Australian Energy Regulator

⁵ In contrast, in the United Kingdom energy markets, voluntary invocation (as opposed to a managed exit) is precluded under market rules. OFGem is not able to suspend solvent participants. OFGem considers that it is better that it does not become part of businesses risk management strategies. It is only when businesses become insolvent and where a trade sale is not possible, that RoLR events must be declared by OFGem. The AER notes then that the current design of the Australian market, in particular, the size of prudential requirements and the compulsion on the market operator to suspend immediately if prudentials are not met (or lapse), makes voluntary invocation difficult to prevent in Australia.