Retailer authorisation applications:

Additional information to support your application

Purpose

The Australian Energy Regulator (AER) is responsible for administering retailer authorisations to businesses seeking to enter the energy market (gas and electricity). The National Energy Retail Law (Retail Law) sets out 3 entry criteria that you must satisfy as an applicant to obtain a retailer authorisation:

- **organisational and technical capacity** – you must have the necessary organisational and technical capacity to operate as a retailer
- **financial resources** – you must have the financial resources or access to resources to operate as a retailer
- **suitability** – you must be a suitable person to hold a retailer authorisation**.**

Applicants seeking a retailer authorisation are required to submit an application in accordance with the AER's Retailer Authorisation Guideline (Version 2, 2014) (**Guideline**).

As stated in the Guideline, the AER's authorisation assessment is a point-in-time assessment.[1] The Guideline also provides that applicants must provide any additional information that will help the AER to assess an applicant's ability to meet each of the 3 entry criteria.[2]

The AER is currently seeking additional information to assist in establishing whether applicants can satisfy the entry criteria, in light of current market conditions. The need for this additional information will be reviewed and may change as market conditions change.

This additional information sought applies to both electricity and gas applications.

Additional information

The following additional information will help us assess your ability to meet the entry criteria:

- operating cost considerations, including demonstrating you can meet significantly increased prudential costs – we expect detailed, itemised costs[3]
- stress testing and sensitivity analysis by presenting scenarios demonstrating financial profit, loss and cash flow if customer acquisition plans vary, or wholesale prices and costs were to increase significantly over a 3-year timeframe[4]

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[1] AER, *Retailer authorisation Guideline v. 2*, 2014: p. 5.

[2] Refer to discussion on 'Entry criteria' in the *Retailer Authorisation Guideline v. 2*: https://www.aer.gov.au/retail-markets/guidelines-reviews/retailer-authorisation-guideline-december-p014

[3] Refer to discussion on 'Financial capacity criterion' in the Guideline, particularly p.15 – 16.

[4] Refer to footnote 3, and discussion on 'Business plans' in the Guideline, p. 12.

- strong business plan supported by a financial plan, including organisational and technical capacity[5]
- demonstrated expertise in the business relating to wholesale energy markets and risk assessment and mitigation[6]
- risk management and risk mitigation measures, including strategies to deal with additional risks associated with higher costs – this would include, for example, information about purchasing arrangements and contracting positions indicating the level of wholesale market exposure (including if the applicant is proposing / intending to purchase from other sources, such as another retailer)[7]
- financial resources demonstrating an ability to meet higher costs, including sufficient liquid reserves to meet higher unforeseen costs.[8]

Information on how to provide this supporting information is set out below.

Organisational and technical capacity criterion

A key element of a resilient business is strong organisational and technical capacity. Key office holders must have the necessary expertise and experience to manage energy retail operations and guide the business successfully when external circumstances change.[9]

To assess this, it is relevant for the AER to consider the skills, experience and compliance history of an applicant's director(s) and key office holders. To demonstrate an appropriate level of oversight over key business functions, particularly risk mitigation, we look for relevant experience and demonstrated competencies of key office holders.[10]

Risk management

You should:

- detail the organisational approach to managing risks
- identify particular risks to the business
- detail how each risk will be mitigated.

This is to be covered in detail in your risk management framework, which should include:

- a risk appetite statement articulating how much risk is acceptable to you
- clear processes for identifying risk events – this includes identifying the risks that are inherent in your proposed business and determining the likelihood of occurrence and impact to produce a 'risk map'. For each risk, you should also specify controls you would apply and identify the residual risk position and how it will be managed

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[5] Refer to 'Organisational and technical capacity criterion' in the Guideline, p. 12 – 15.

[6] Refer to 'Compliance and risk management strategies', and 'Required information – organisational and technical capacity' in the Guideline, p. 12 – 14.

[7] Refer to the discussion on risk management noted in footnote 6, and discussion on managing financial risks and costs, p. 15 – 17.

[8] Refer to footnote 7.

[9] Refer to footnote 5.

[10] Refer to 'Energy market experience' in the Guideline, p. 12.

- proactive and reactive strategies for managing risk events, systems, reports and business controls, ensuring transparency of risk positions and management activities. The risk management framework should also set out the roles of responsible officers, and include documentation on the policies and procedures providing guidance for day-to-day risk management activities.

The risk management framework should be proportionate to the size, operating model and complexity of your proposed retail operations.

You should include a risk management framework together with evidence that the framework and associated policies/procedures have been through an external assurance process.[11]

Wholesale price risk

Applications should carefully outline the approach to managing wholesale price risks.

Using the customer acquisition numbers and associated expected customer load for the following 3 years presented in the baseline business plan (discussed in the Financial capacity criterion section), describe how you plan to manage wholesale price risk.

In responding to this question, you should consider the following.

1. For electricity, do you have a plan to hedge part or all of the load? For gas, do you have a plan to mitigate wholesale price risks? Describe your intended strategy in detail.
2. What proportion of your customer load do you anticipate purchasing from the electricity or gas spot markets?
    a) Ensure the wholesale price risk incurred through spot market trading is addressed in your risk management framework
3. For gas, if you purchase from the spot market, your risk assessment and mitigation approach should cover the possibility that the time between purchase of gas and customer payment is 60 days, and the administered price applies during this period.
4. For electricity, will you trade on the ASX or purchase over the counter (OTC) products?
5. If purchasing electricity OTC products:
    a) Who do you plan to purchase from?
    b) Have you made any preliminary arrangements or sought to obtain pricing quotes to purchase OTC products? Provide details and evidence if available.
6. Who in your business will be responsible for purchasing contracts? Outline all relevant experience they have in managing risk and purchasing wholesale electricity and gas contracts.

If planning several ways to mitigate wholesale price risk – for example, acquiring generation assets, entering long-term supply contracts with third parties or making other purchasing arrangements – you should also clearly describe how these measures will limit wholesale price risks and describe how residual wholesale price risks will be mitigated.

Financial capacity criterion

Energy retailers are exposed to changing costs, particularly due to fluctuating wholesale prices. Another variable is customer acquisition plans, which are also likely to vary from initial

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[11] Refer to 'Required information - organisational and technical capacity' in the Guideline, p. 14.

expectations. A retailer is more likely to sustain and grow its business if it is able to manage high costs and navigate periods of slower/greater than expected customer acquisition activity.

Retailer authorisation applications should present a business model supported by financial information (cash flow, profit and loss and balance sheet statements).[12]

To demonstrate your capability to manage business risks, including changing wholesale prices and customer acquisition numbers, we ask you to 'stress test' your finances by applying a specified series of stress tests to your business plan and finances. The stress tests are set out in Questions 1 to 5 below. These questions provide you with an opportunity to demonstrate the resilience of your business model and financials.

Stress tests

Questions 1 to 5 asks you to consider and present financial information for the business over a 3 year period.

Question 1 asks for a 'baseline business case'.

Questions 2 to 5 ask you to present the same information (profit and loss, cash flow and balance sheet statements), incorporating the identified change(s) at each question, holding all else equal.

Baseline business plan

1. Present financial information: profit and loss, cash flow and balance sheet statements, including 3 years of data, shown in monthly increments. The information should correspond to your business plan, and organisational and technical capacity.

In presenting this information you should also clearly set out the assumptions underlying the data, including customer acquisition numbers (shown in monthly increments), and associated customer load under POE50 demand conditions.[13] Customer load should be shown as average demand for each month, in Mega Watt hours (MWh) for electricity and Gigajoules (GJ) for gas.

Stress test scenarios

Present the same financial information provided in the baseline business plan (profit and loss, cash flow and balance sheet statements) for 3 years, presented in monthly increments, for each of the scenarios listed below.

2. The customer acquisition path is 50% lower than that specified in the baseline business plan. Hold all else equal.
3. The customer acquisition path is 200% higher than that specified in the baseline business plan. Hold all else equal.
4. Present financial information for the scenario where:
    a) the customer acquisition path is 200% higher than that specified in the baseline scenario, and

[12] Refer to 'Business plans' in the Guideline, p. 12.

[13] POE50 demand conditions refers to 'mid-range' demand outcomes, that is, a demand outcome with a 50 percent probability of exceedance.

b) for electricity, the wholesale electricity cost equals the Annual Average Volume Weighted Price for the preceding 12 months for the most expensive region. See Appendix A

c) for gas, the wholesale gas cost equals the highest financial year average cost in the preceding 5 years in the Short Term Trading Markets (STTMs). See Appendix A.

5. Present financial information for the scenario where:

a) the customer acquisition path is 200% higher than that specified in the baseline business plan, and

b) for electricity, the average wholesale electricity cost equals the Average ASX-traded Base Future Contract Price for contracts available for the following 12-month period, for the most expensive region. See Appendix A.

In responding to each question you should also demonstrate a clear understanding of the wide-ranging effects of the identified change on your business and set out appropriate risk mitigation measures.

Risk mitigation measures may include evidence of available cash reserves, including bank balances, loan guarantees and the like to ensure the business is able to continue as an active participant by servicing all existing customers and continuing to grow its customer base.

Also consider whether other risk mitigation measures may be necessary to manage risks to the business, such as changes to the organisational and technical capacity of the business.

Suitability criterion

In assessing an applicant's organisational capacity to meet the obligations of an energy retailer we also consider matters relating to the applicant's suitability.[14]

Applications should clearly set out information on the experience, skills and suitability of the director/s and key office holders of the business, demonstrating they are suitable persons to oversee key business operations. The information provided on the suitability criterion should be relevant to both the current market conditions and retail operations more generally.

AER contacts

If you have any questions about this note, contact the AER's Authorisations team via email: AERauthorisations@aer.gov.au.

Appendix A

The Annual Average Volume Weighted Price (AAVWP) for each region is published following the close of the calendar year and financial year in the AER's *Wholesale markets quarterly report*. The relevant AAVWP price to use for the stress test in question 4 is $178/MWh, based on the highest priced region for the financial year ending 30 June 2022.

The Average ASX-traded Base Future Contract Price (ASXFC) for contracts available for the following 12-month period are published on the ASX Energy website. The relevant contract

[14] The Suitability assessment is discussed on p. 17–19 of the Guideline.

price to use for the stress test in question 5 is $253/MWh, based on the highest priced region as at 30 June 2022.

The financial year average gas prices for the STTMs are published on the AER website in the wholesale statistics subsection of the wholesale markets section.[15] The relevant price to use for the stress test in question 4 is $15.54 per Gigajoule (GJ). This is calculated as at 1 July 2022.

Inquiries about this publication should be addressed to:

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[15] https://www.aer.gov.au/wholesale-markets/wholesale-statistics/gas-market-prices