



Draft

## **Retailer of Last Resort statement of approach**

July 2011

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### **Amendment record**

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## Shortened forms

ACCC/AER Information Policy	<i>ACCC–AER Information policy: The collection, use and disclosure of information, available from the AER’s web site</i>
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Backup RoLR	A registered RoLR who may be designated if a default RoLR fails
National Energy Customer Framework	The National Energy Retail Law, National Energy Retail Rules and National Energy Retail Regulations
Distributor	Distribution Network Service Provider
Electricity Law	National Electricity Law
Electricity Rules	National Electricity Rules
RoLR register EoI	Retailer of Last Resort register expression of interest
Gas Law	National Gas Law
Gas Rules	National Gas Rules
NEM	National Electricity Market
NMI	National Metering Identifier
Retail Law	National Energy Retail Law
Retail Regulations	National Energy Retail Regulations
Retail Rules	National Energy Retail Rules
RoLR	Retailer of Last Resort

# **1 Introduction**

## **1.1 Background**

In March 2011, legislation to create a new National Energy National Energy Customer Framework was passed. The National Energy Customer Framework, comprising the Retail Law, National Energy Retail Rules (Retail Rules) and National Energy Retail Regulations (Retail Regulations), has been developed through extensive consultation by the Ministerial Council on Energy (MCE). In December 2010, the MCE agreed that jurisdictions would work towards a common target commencement date of 1 July 2012.

The Retail Law makes provision for a national Retailer of Last Resort (RoLR) scheme to provide common arrangements across jurisdictions in case of retailer failure. Under this scheme, the AER is responsible for the registration and appointment of RoLRs and the determination of RoLR cost recovery schemes to allow for the recovery of RoLR scheme costs.

## **1.2 Purpose of RoLR statement of approach**

Under the Retail Law, the AER is required to publish RoLR guidelines. These guidelines are required to specify some aspects of the registration and appointment framework (such as multiple RoLR appointment) and RoLR cost recovery (such as the information to be included in a RoLR cost recovery scheme).

While not required under the Retail Law, the AER has also decided to set out a broader RoLR statement of approach. This is designed to complement the RoLR guidelines by providing other information on RoLR registration and appointment and RoLR cost recovery to assist industry understand the operation of the overall RoLR framework.

In particular, the draft RoLR statement of approach sets out:

- when the AER will call for expressions of interest to register as a RoLR
- when the AER will make a “designation decision” (the decision to appoint someone as a RoLR) and if it does, what information it will use to make its decision
- how the AER may assess whether costs incurred on or after a RoLR event are reasonable
- that the AER will not impose limits on the amount of, or classes of, costs that the RoLR is entitled to recover
- that RoLR cost recovery should not result in significant price shocks for small customers, and
- that the RoLR’s recovery of costs should generally extend more broadly than the failed retailer’s customers.

### **1.3 Structure of RoLR statement of approach**

The RoLR statement of approach is structured as follows:

- chapter 2 explains the objectives the AER has considered in developing the RoLR scheme
- chapter 3 sets out the registration framework (registration occurs before a RoLR event)
- chapter 4 sets out the designation framework (appointment of designated RoLRs occurs at the time of a RoLR event) including the criteria the AER will apply
- chapter 5 gives details of cost recovery schemes and the process for RoLRs to apply for costs after a RoLR event.

## 2 Objectives of a RoLR scheme

The AER must in developing the national RoLR scheme under Part 6 of the Retail Law, do so in a manner which will or is likely to contribute to the achievement of the National energy retail objective (retail objective).<sup>1</sup> The retail objective is:

to promote efficient investment in, and efficient operation and use of, energy services for the long term interests of consumers of energy with respect to price, quality, safety, reliability and security of supply of energy.<sup>2</sup>

The AER must also develop the RoLR scheme in a manner compatible with the development and application of consumer protection of small customers (including but not limited to hardship customers).<sup>3</sup>

The AER's RoLR scheme objectives are designed to promote the above objectives, and foster conditions where retailers, distributors and other energy industry participants are confident to participate in the RoLR scheme. These scheme objectives are:

1. that customers maintain continuity of supply in the event of retailer failure
2. that customers' interests are protected with respect to price (i.e. through competition in the RoLR appointment process) and other terms and conditions
3. the integrity of wholesale market arrangements (i.e. payments between retailers and generators/upstream suppliers)
4. the continuity of payments to suppliers of transmission/distribution services and other ancillary energy service providers
5. that RoLRs have an opportunity to recover reasonable costs.

With these objectives in mind, the AER considers the RoLR scheme should achieve the following:

1. result in the appointment of designated RoLR with the financial and organisational capacity to carry out the role
2. minimise the risks of a designated RoLR itself failing shortly after being appointed as a designated RoLR
3. set out clearly how the appointment of designated RoLRs will be made
4. not discourage trade sale opportunities
5. not be unduly costly to administer
6. be able to be implemented quickly and simply.

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<sup>1</sup> s.205 National Energy Retail Law.

<sup>2</sup> s.13 National Energy Retail Law.

<sup>3</sup> s.205 National Energy Retail Law.

## 3 Registration Framework

### 3.1 General information

This chapter sets out the process the AER will use to register RoLRs and to ensure retailers are registered for all retailer failures including the failure of default RoLRs.

### 3.2 Expressions of Interest

The AER will call for expressions of interest (EoIs) from retailers to register as RoLRs (RoLR registration EoI) upon the commencement of the Retail Law.<sup>4</sup> Following this initial call, the AER will seek EoIs for default RoLRs every three years or at such times it considers appropriate.<sup>5</sup> For additional RoLRs, the AER will seek EoIs from retailers every year.

Retailers seeking registration as a default RoLR or additional RoLR will be required to complete a RoLR registration EoI form, set out in the RoLR guidelines and available on the AER's website at [www.aer.gov.au](http://www.aer.gov.au). The RoLR registration EoI form seeks information from the retailer including whether they seek to attach terms or conditions to their registration (discussed in 4.4).

The RoLR registration EoI form sets out information that may be provided by a retailer to demonstrate it satisfies the RoLR criteria. The RoLR criteria require the retailer to demonstrate adequate financial resources, necessary organisational and technical capacity suitable to be the RoLR and any other matters the AER considers relevant.<sup>6</sup> The AER must take the RoLR criteria into consideration when deciding whether to register RoLRs.<sup>7</sup> However, the AER is not obliged to register retailers even though they satisfy or appear to satisfy the RoLR criteria.<sup>8</sup>

The AER may register a retailer as a default RoLR (as opposed to an additional RoLR) even if it has not submitted an EoI.

The AER may register one or more retailers as additional RoLRs for each electricity connection point, and for each gas distribution system.<sup>9</sup> All authorised energy retailers from participating jurisdictions will be able to seek registration as an additional RoLR. However, a retailer can only be registered as an additional RoLR for connection points (electricity) or distribution systems (gas) for which it is not the default RoLR.<sup>10</sup>

The rest of this chapter considers specific registration requirements for default RoLRs or additional RoLRs, areas of registration and the publication of a RoLR register.

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<sup>4</sup> This will be subject to any transitional arrangements applying to default RoLR arrangements.

<sup>5</sup> s.124(1) National Energy Retail Law.

<sup>6</sup> s.123 National Energy Retail Law.

<sup>7</sup> ss.125(6), 126(2) National Energy Retail Law.

<sup>8</sup> s.125(11), 126(9) National Energy Retail Law.

<sup>9</sup> s.126(1) National Energy Retail Law.

<sup>10</sup> ss. 126 (5) and (6) National Energy Retail Law.

Finally, the AER specifies its approach to designating RoLRs should a default RoLR itself fail (backup RoLRs).

### **3.3 Default RoLRs**

The AER must ensure that a default RoLR is registered to each connection point in the case of electricity, and each distribution system in the case of gas. Default RoLRs are required to take on customers for electricity connection points and gas distribution systems they are registered against in the absence of other instructions from the AER to AEMO before a RoLR event.<sup>11</sup>

#### *Meeting RoLR criteria*

Unlike additional RoLRs (see 3.4 below), the AER does not propose allowing default RoLRs to register conditionally to take on, for example, a certain number of customers. Instead, default RoLRs will need to be able to take all customers of the failed retailer in their registered area at the time of a RoLR event. Therefore, in appointing default RoLRs, the AER will need to consider a retailer's ability to access potentially large financial resources at short notice (such as to meet significantly increased prudential requirements) as well as business support and IT systems to accommodate the transfer of a large number of customers. This suggests that smaller retailers with smaller financial bases and business systems will not be suited to being default RoLRs.

#### *Periodic reviews and ad hoc reviews of default RoLR arrangements*

The AER will review default RoLR arrangements on a three yearly basis at the same time as it reviews backup RoLR arrangements (discussed at 3.7 below).

The AER notes there may be circumstances when default RoLR arrangements might need to be reviewed at other times, for example if the default RoLR itself fails or if there is merger activity in the market. In considering whether there is a need to review default RoLR arrangements outside the three-yearly reviews, the AER will consider whether there has been a material change in the market or a retailer(s) circumstances.

#### *Calls for EoIs*

The AER will generally call for EoIs at least six months before the three-yearly reviews in order to be able to provide time to consider who should be registered as default RoLRs based on EoIs, or who should be required to be the default RoLR, if necessary. In other circumstances, however, such as the exit of a default RoLR from the market, the AER may need to call for EoIs in shorter timeframes.

#### *Standing instructions to AEMO*

The AER will provide details of the default RoLR arrangements to AEMO as part of its standing instruction. The standing instructions will inform AEMO which retailers

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<sup>11</sup> s. 132(1) National Energy Retail Law.

are the default RoLRs and when they should be appointed as the designated RoLRs should a retailer fail.

### 3.4 Additional RoLRs

A retailer may seek registration to be an additional RoLR for an electricity connection point or gas distribution system for which they are not the default RoLR.

In the event of retailer failure, the AER may appoint as the designated RoLR an additional RoLR instead of, or in addition to, the default RoLRs. However, the AER must consider whether the retailer continues to satisfy the RoLR criteria before it appoints the additional RoLR as a designated RoLR. Further, the AER must notify AEMO of the additional RoLR's appointment as a designated RoLR before the day on which customers are transferred. As a result, the scope of the AER to appoint an additional RoLR as a designated RoLR may be limited where the AER is given little notice of a RoLR event.

Therefore, the AER has developed measures that will assist the selection process for the designated RoLRs. This includes establishing two categories of additional RoLR registration—a firm offer category and a non-firm offer category. The firm offer registration category allows retailers to pre-commit to the terms and conditions under which they would be prepared to be appointed as a RoLR. This enables the AER to have the information it needs to quickly make appointment decisions and the prior agreement of retailers to make the appointments. The non-firm offer category enables retailers to register their interest to be a RoLR, but does not commit them to acting in that role. Retailers are able to register for either or both additional RoLR categories.

The remainder of this section considers the two categories of additional RoLR registration.

#### *Additional RoLR with firm offer*

An additional RoLR with firm offer commits to being a RoLR but with certain restrictions or conditions.

While any term or condition may be proposed by the AER or retailer, the AER has established standard terms and conditions which it considers reasonable for additional RoLR with firm offer registration. The standard terms and conditions are set out in RoLR registration EoI form. They include:

- Jurisdiction/distribution system—Electricity retailers will be able to identify which jurisdiction/s they are prepared to serve as the designated RoLR. Gas retailers will be able to nominate which distribution system/s they are prepared to act as the designated RoLR.
- Customer numbers—Retailers may identify the number of customers they are prepared to serve as the designated RoLR.
- Customer class—Electricity retailers may identify whether they are prepared to serve large or small customers as the designated RoLR. Designated RoLRs in gas

will be required to take on all customer classes, since only one registered RoLR may be appointed as the designated RoLR for a gas distribution system under the Retail Law.<sup>12</sup>

- Customer load—Retailers may nominate the customer load they are prepared to take on as the designated RoLR.
- Cost recovery variation—Retailers may nominate how they intend to vary their RoLR cost recovery scheme, such as waiving RoLR event costs.

The AER also requires retailers seeking additional RoLR with firm offer registration to agree to be appointed as a RoLR without first being consulted by the AER.

A retailer's offer will be valid for three months. At the end of this period, retailers will need to confirm their offer with the AER. This includes identifying whether any events or circumstances have materially affected the retailer's ability to satisfy the RoLR criteria.

#### *Additional RoLR with non-firm offer*

An additional RoLR with non-firm offer does not commit to accepting customers, but has indicated its interest in being a designated RoLR if an event occurs. It may also propose terms and conditions but, unlike an additional RoLR with firm offer, they are not binding. Any conditions of registration will inform, but not determine, the AER's appointment decision as the retailer will need to be notified prior to appointment. Although a registered RoLR's consent is not required for appointment,<sup>13</sup> the AER considers that it is prudent to confirm that an additional RoLR with non-firm offer is still prepared and capable of being appointed on the terms and conditions it previously proposed.

#### *Meeting RoLR criteria*

Unlike default RoLRs (see 3.3 above), additional RoLRs may register on a conditional basis such as up to a maximum number of customers. Where such conditions exist, the AER will consider these in assessing the retailer's application to be registered (for example, whether the retailer's business systems support taking on the number of customers specified in a condition).

#### *Periodic review of additional RoLR registration*

The AER will review the registration of additional RoLRs with firm offers every three months and additional RoLRs with non-firm offer every two years.

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<sup>12</sup> In accordance with current AEMO systems, customer class options for electricity are restricted to NMI (small/large) classifications within MSATS.

<sup>13</sup> s. 132(4) National Energy Retail Law.

### *Ad hoc review of additional RoLR registration*

The AER will undertake an ad hoc review of the registration of an additional RoLR if the AER becomes aware of events or circumstances that may or will affect the retailer's ability to satisfy the RoLR criteria.

### *Calls for EoIs*

The AER will call for EoIs to be an additional RoLR in either the firm or non-firm category on a yearly basis.

## **3.5 Area of registration**

The AER must register RoLRs on the basis of distribution system for gas and connection points (NMI) for electricity. However, the AER may group electricity connection points including by TNI, local retailer area or jurisdiction. This section sets out the AER's approach to registering RoLRs in the NEM.

### *Default RoLRs—electricity*

The AER will register electricity default RoLRs by grouping connection points to TNI, local retailer area or NEM jurisdiction. The AER's default RoLR registration approach will be guided by the AER's RoLR scheme aims and objectives, including maintaining the integrity of wholesale markets and the continuity of payments at the time of a RoLR event. This may mean that in many cases, the smallest of these grouping of connection points, TNI, is used in order to best ensure against cascading RoLR failures.

### *Additional RoLRs—electricity*

For additional RoLR registrations, the AER considers it appropriate that additional RoLRs register by jurisdiction for electricity. This will not prevent additional RoLRs from proposing conditions on offers, such as the total customer numbers they are willing to take. The AER considers this will reduce complexity at the time of a RoLR event, whereby the amount of offer/registered area combinations are likely to be reduced enabling the AER to reach a designation decision sooner.

As noted earlier, a retailer can only be registered as an additional RoLR for connection points for which it is not the default RoLR.<sup>14</sup> In situations where a retailer is the default RoLR for only some customers in a jurisdiction, it may also be registered to be an additional RoLR for the other customers in that jurisdiction.

## **3.6 RoLR register**

Section 127 of the Retail Law requires the AER to maintain and publish on its website a register of RoLRs. The register of RoLRs must include particulars of the RoLRs registered, and must indicate whether the retailer is registered as a default RoLR or as an additional RoLR.

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<sup>14</sup> ss. 126 (5) and (6) National Energy Retail Law.

The AER's RoLR register sets out the following information:

- retailer name
- registration classification
- jurisdiction
- registration area (for default RoLRs) and
- terms and conditions (summary only).

The RoLR register is available at [www.aer.gov.au](http://www.aer.gov.au). The RoLR register is updated whenever there is a new registered RoLR or a change to a retailer's RoLR registration.

### **3.7 Backup RoLRs**

Backup RoLR arrangements are not a category of registration. These are arrangements the AER will determine based on registered default RoLRs and additional RoLRs. Backup RoLR arrangements are required in the event of the failure of a default RoLR(s).

Since only one default RoLR can be appointed to an electricity connection point or gas distribution system, it is necessary to provide an immediate instruction which AEMO can implement should the default RoLR itself fail. Therefore, the AER will need to consider default RoLR failure scenarios in advance and advise AEMO which remaining default RoLRs/ additional RoLRs are to be appointed.

#### *Periodic reviews and ad hoc reviews of backup RoLR arrangements*

The AER will review backup RoLR arrangements on a three-yearly basis at the same time as it reviews default RoLR arrangements.

The AER notes that there may be circumstances when backup RoLR arrangements might need to be reviewed at other times, for example if a default RoLR or backup RoLR itself fails or if there is merger activity in the market.

#### *Standing instructions to AEMO*

The AER's standing instructions to AEMO will direct AEMO to transfer customers to one or more of the remaining default RoLR(s) or registered additional RoLRs.

#### *Grouping of customers*

The AER will make backup RoLR arrangements by grouping default RoLR connection points by TNI (in the case of electricity) and by distribution system (in the case of gas). The AER's approach as to which TNIs or gas distribution systems to allocate to which registered RoLRs will be guided by the AER's RoLR scheme aims and objectives, including maintaining the integrity of wholesale markets and the continuity of payments at the time of a RoLR event.

## 4 Designation Framework

### 4.1 General information

The RoLR scheme specifies that default RoLRs are appointed as the designated RoLR at the time of a RoLR event unless the AER provides AEMO with written notice replacing those arrangements.<sup>15</sup> It follows that the appointment of any additional RoLR as a designated RoLR for a RoLR event will depend on the AER having sufficient notice to consider whether it is preferable to make an appointment decision different to default RoLR arrangements. To improve the ability of the AER to appoint additional RoLRs as designated RoLRs, the AER will have an information protocol with AEMO. The information protocol will cover the AER receiving information from AEMO and also enable the AER to quickly notify AEMO of designation decisions.

The AER may also request information from retailers if a RoLR contingency event occurs to assist with its appointment decision.<sup>16</sup> A contingency event can include any material default by a retailer concerning its obligations under energy laws with respect to the payment of money, the provision of securities or otherwise of a financial nature.<sup>17</sup>

When appointing the designated RoLRs, the AER must take account of the designation criteria.<sup>18</sup> These aspects of the designation framework are discussed further below.

### 4.2 Which registered RoLR can be considered?

A major factor in the AER's selection of designated RoLRs for appointment will be the length of time the AER has to make the decision. Figure 4.1 below considers which registered RoLRs may be considered for appointment as designated RoLRs according to the amount of notice the AER receives of an impending RoLR event. The example illustrates that the more warning the AER has, the more registered RoLRs it will be able to consider.

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<sup>15</sup> s.132(1) National Energy Retail Law.

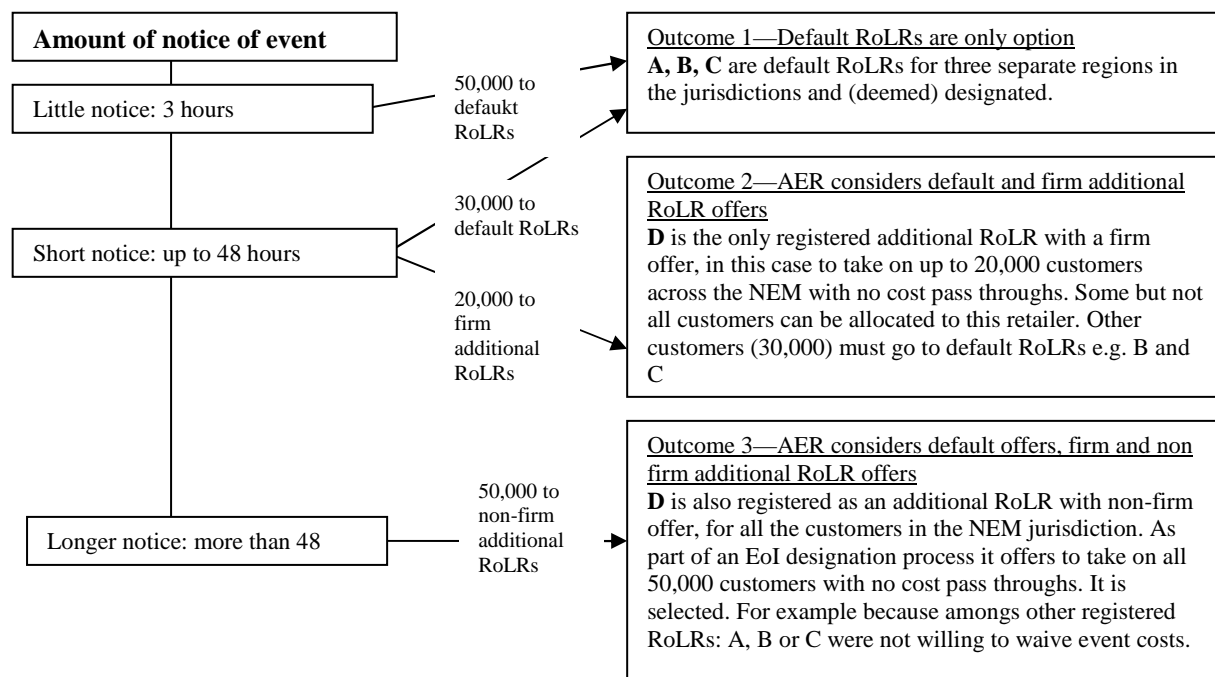
<sup>16</sup> s.130 National Energy Retail Law.

<sup>17</sup> s.130(2) National Energy Retail Law.

<sup>18</sup> s.133(1) National Energy Retail Law.

**Figure 4.1 Which registered RoLRs may be considered?**

**Retailer X** has 50,000 electricity customers across a NEM jurisdiction and there is a RoLR event.



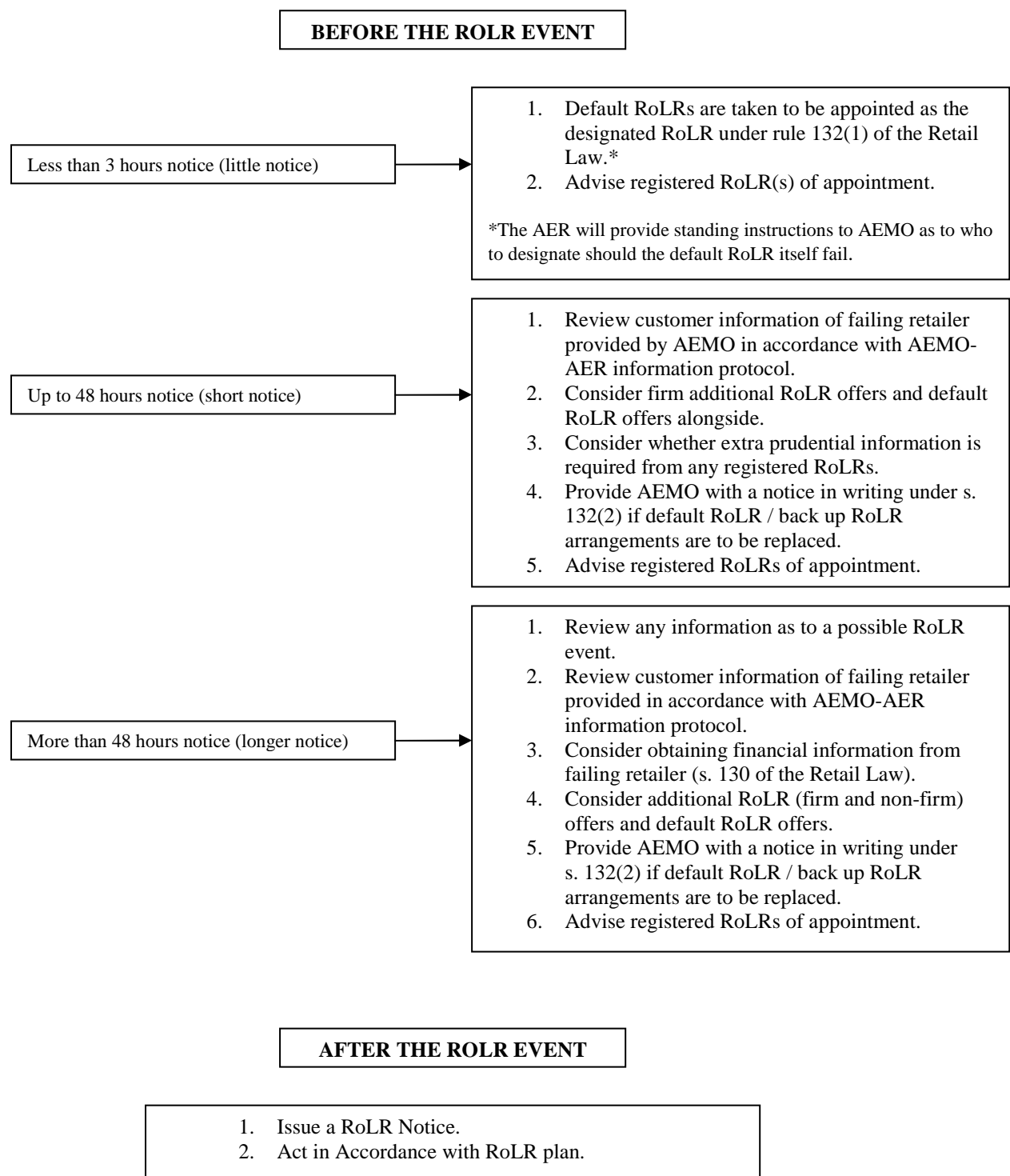
Outcome 1 shows that where there is less than a few hours notice of a RoLR event, the AER is most likely to appoint default RoLRs. Outcome 2 shows that with short notice (i.e. up to 48 hours) the AER may also be able to consider additional RoLRs with firm offers. Additional RoLRs with firm offers have agreed not to be consulted prior to being appointed as designated RoLRs (up to the maximum permitted by their terms and conditions).<sup>19</sup> Outcome 3 reflects that where the AER has more than 48 hours notice of a RoLR event it may be able to consider (and consult with) other registered RoLRs. This would include non-firm additional RoLRs who have *not* agreed to be designated without further consultation at the time of an event.

### 4.3 Information flows

The information the AER will take account of and provide before making a designation decision is highlighted in figure 4.2.

<sup>19</sup> The AER notes that there would have been enough time with Australia's two RoLR events for additional RoLRs with non-firm offers to have been considered. Energy One requested its suspension from the market and Jackgreen suspension was triggered after a publicly announced creditors' action to wind up.

**Figure 4.2: RoLR information flows**



### *Little notice*

With little notice of a RoLR event the AER would not base its designation decision on any current information but rely on default/backup RoLR arrangements.

### *Short notice*

With short notice the AER would use information obtained from AEMO in accordance with AEMO–AER information protocols to provide the AER with information at the time of an event as to:

- the number of customers affected and/or the load
- the geographic location of the customers or load affected
- AEMO’s current prudential limits for registered RoLRs and their ability to absorb the new customer load.

The AER notes that a retailer’s current prudential limits may not accurately reflect its ability to take on extra customers following a RoLR event. Even if a retailer’s current prudentials are insufficient to absorb a certain number of customers or load, the retailer may be able to quickly increase its credit by obtaining further bank guarantees. If a RoLR appointment was likely to result in a retailer needing further credit (on the advice of AEMO), the AER would endeavour to satisfy itself that the retailer could secure the extra credit before appointing it as a RoLR.

### *Longer notice (use of contingency event powers)*

In addition to considering information from AEMO, where there is longer notice of a RoLR event, the AER may consider requesting information from the failed retailer and may sound out all registered RoLRs (including those in the non-firm category). The AER’s contingency event powers under the Retail Law enable the AER to seek more information from a retailer where it thinks there are circumstances affecting that retailer which might lead to a RoLR event.<sup>20</sup> The purpose of these provisions is to allow the AER, AEMO and other participants to potentially be informed earlier of a RoLR event. Powers extend to the AER being able to advise registered RoLRs of retailer information to assist with expressing interest in being a RoLR.

The AER has significant discretion in exercising these powers, including which parties are informed about a potential RoLR event.<sup>21</sup> However, the AER might not exercise these powers if it has concerns that the exercise of these powers (particularly informing distributors or retailers) may unintentionally provoke or bring forward a retailer failure. For example, releasing information as to a likely RoLR event may preclude opportunities for a trade sale. Therefore before the AER releases any information of a RoLR event, acquired under Division 3 of the Retail Law or otherwise, it will consult with the retailer as to any relevant matters such as whether:

- the retailer is close to selling its customer base
- there is a real likelihood of an injection of cash into the business.

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<sup>20</sup> s.130(4) National Energy Retail Law.

<sup>21</sup> s.130(5) National Energy Retail Law.

The AER may request financial information from the retailer to ascertain its circumstances.<sup>22</sup> The kind of information the AER may request is set out at Appendix A.

The AER will generally endeavour to provide the opportunity for a retailer to reach a commercial solution which does not involve a RoLR event. However, where the AER considers that a RoLR event is likely and that it can release information in a way which is unlikely to worsen the situation for the retailer, it may release information for the purposes of RoLR event preparations. The AER will need to strike a balance between the risk of exacerbating the retailer's position, and the benefits which could ensue from allowing more time for parties to prepare for a RoLR event including to make offers to take on customers. Releasing information may be considered unlikely to bring forward a retail failure if:

- a RoLR event is caused by an application to be wound up, or
- a RoLR event involves a retailer effectively allowing itself to be suspended and deliberately exiting the market, or
- the AER intends to revoke a retailer's authority.

In these circumstances, the AER considers it could make enquiries of registered RoLRs as to whether they want to take on any of the failed retailer's customers. The AER would provide information to registered RoLRs as to the likelihood of a RoLR event and information about the likely customers involved.<sup>23</sup> The AER would then require the registered RoLRs it makes enquiries of to submit EoIs within 48 hours through a tender process.

The form of inquiries that the AER would make of registered RoLRs as to whether they want to be appointed as a designated RoLR in the case of a RoLR event are set out in Appendix B.

The AER will exercise its discretion as to when to act under contingency event powers. However, the AER expects that AEMO and retailers will, as required under s. 150 of the Retail Law, inform the AER whenever they have reason to believe there might be a RoLR event. The AER notes this includes the reasonable belief of something which may give rise to some risk of a RoLR event. For example, the AER considers this requires AEMO to inform the AER anytime it issues a call notice in the NEM.

## **4.4 Application of the designation criteria**

The AER will take into consideration the designation criteria before appointing a designated RoLR. This section sets out how the AER may consider the designation criteria in accordance with how much notice of a RoLR event it receives.

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<sup>22</sup> The AER's powers to request information as to a retailer's financial circumstances, including by a Regulatory information notice, are set out under Divisions 3 and 7 of the National Energy Retail Law.

<sup>23</sup> The AER's power to pass on information to registered RoLRs is set out under Division 3 of the National Energy Retail Law.

### *Little notice*

With little notice, the imminence of the RoLR event means that default/ backup RoLR arrangements will be used. These RoLRs are likely to be larger retailers who were assessed against the RoLR criteria as able to take on a potentially large amount of customers.

### *Short notice*

With up to 48 hours notice of a RoLR event, the AER may be able to consider registered RoLR offers of additional RoLRs and default RoLRs. The AER might appoint registered RoLRs as designated RoLR differently to default / backup RoLR arrangements if this resulted in some or all of the following:

- reduced likelihood of cascading retailer failures
- lower costs for customers, for example, if a retailer commits to take customers at a lower cost than a default RoLR
- the appointment of fewer designated RoLRs simplifying the event management process and
- changes to market structure which support longer term competition benefits.

These are other relevant matters the AER would consider for the purposes of the designation criteria. The AER would also pay particular attention to the retailer's customer base and its financial capacity to purchase energy for the additional customers.

### *Longer notice*

The more notice the AER has of an impending RoLR event, the more options it has to make RoLR appointments. The AER would seek offers from all registered RoLRs including default RoLRs and additional RoLRs.

Registered RoLRs would be encouraged to submit their best offers having considered the information available at the time of the event. The AER notes that this extends to allowing additional RoLRs to vary their offers, for example as to how many customers they are willing to take or as to RoLR cost recovery schemes.<sup>24</sup>

When calling for EoIs, the AER suggests that retailers should be given at least 48 hours to respond to a request for offers if time allows. The timeframe for the AER to appoint a RoLR will depend on the number of responses the AER receives. However, it anticipates that it would then make a decision within 48 hours. The designation criteria the AER would apply would be the same as for short notice considerations.

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<sup>24</sup> s. 133(2) Allows the registered RoLR and the AER by agreement to vary the RoLR's cost recovery scheme for the purpose of RoLR designation.

## 5 RoLR cost recovery schemes

This chapter sets out the general principles which the AER will consider when making a cost recovery scheme determination. It discusses some hypothetical RoLR event scenarios and proposes the cost recovery scheme and distributor payment determination the AER would consider consistent with the principles in s.166(7) of the Retail Law and the retail objective.

The AER notes the cost recovery schemes for the hypothetical RoLR event scenarios discussed below are not binding principles on the AER's exercise of its powers. Rather, they serve as examples of considerations which the AER will take into account when exercising its powers under Part 6 Division 9 of the Retail Law. The AER further notes the proposed cost recovery schemes for the RoLR event scenarios are of a high level and under s. 166(1) of the Retail Law, the AER would need to make a cost recovery scheme determination for each designated RoLR that submits an application for a cost recovery scheme. This means, depending on the cost recovery application and the individual circumstances of each designated RoLR, different cost recovery schemes may apply for each RoLR for the same RoLR event.

### 5.1 General principles for cost recovery scheme determination

This section outlines the general principles which the AER will consider when determining a cost recovery scheme. The AER considers these principles are consistent with those outlined in s. 166(7) and s. 205 of the Retail Law. These general principles are not binding, however if the AER does deviate from them in making a RoLR cost recovery scheme determination, it will provide reasons for its departure in the decision.

#### 5.1.1 Assessment of reasonable costs

##### *RoLR scheme costs incurred during and following a RoLR event*

To assess whether the costs incurred on and after a RoLR event are reasonable, the AER will assess whether the actions of the designated RoLR in performing its obligations have been prudent and minimised the costs incurred in the circumstances. To assist the AER in its assessment, the designated RoLR should provide supporting documents of its decision-making processes.

##### *RoLR scheme preparation costs*

The AER considers it reasonable that the recovery of preparation costs be limited to a RoLR's efficient costs. The AER considers a default RoLR will have sufficient time to scope and plan the work it needs to undertake to prepare for a RoLR event. Accordingly, the AER will scrutinise preparation costs more closely than costs incurred on or after a RoLR event.

#### 5.1.2 Limits will not be imposed on the classes or magnitude of costs

As the RoLR should be provided with a reasonable opportunity to recover its reasonable costs and given the need to ensure the market integrity and security of the

energy market following a RoLR event, limits on the classes or magnitude of costs will generally not be imposed.<sup>25</sup>

### **5.1.3 Cost recovery mechanisms**

#### *Consideration of price shocks for small customers*

The AER must exercise its functions and powers in a manner compatible with the development and application of protection for small customers, including protection relating to hardship customers.<sup>26</sup> Thus, cost recovery should not result in onerous price shocks for small customers, as this may present hardship issues for some customers. For this reason, the AER does not consider upfront fees are appropriate where the fee imposed is onerous for the transferred small customers of the failed retailer.

#### *Extent of recovery of costs*

The AER considers the RoLR scheme benefits all energy market participants, by providing market integrity and security following a RoLR event. Thus, the AER considers it appropriate cost recovery extends beyond just the customers of the failed retailer.

Consistent with the need to prevent significant price shocks for small customers, cost recovery should occur over the largest customer base which is appropriate to the RoLR event. The Retail Law provides for the spreading of the RoLR scheme costs of a RoLR event through the distributor payment determination.

## **5.2 General principles for the apportionment of the distributor payment determination**

### **5.2.1 Appointment of multiple distributors for the distributor payment determination**

#### *Financial obligations imposed by the distributor payment determination on distributors*

If a distributor is likely to have onerous financial obligations placed upon it by the distributor payment determination, the AER will likely appoint multiple distributors. The AER considers the short term financial impact of the distributor payment determination should be minimised, as distributors wear short term funding constraints as a result of making payments.

#### *Appointment of distributors where retailer failure affects multiple jurisdictions*

Where a retailer failure affects customers in multiple jurisdictions and the distributor payment determination is selected as a cost recovery mechanism, the AER will likely appoint distributors in each of the affected jurisdictions. This will minimise the short term financial impacts on distributors and is consistent with the cost recovery scheme

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<sup>25</sup> s. 166(7)(a) National Energy Retail Law.

<sup>26</sup> s. 205 National Energy Retail Law.

principle to recover costs over the largest customer base appropriate to the circumstances.

### **5.2.2 Apportionment of the distributor payment determination between distributors**

The AER will apportion the liability for distributor payment determinations on a case by case basis. Such an allocation must support the retail objective and be fair and reasonable in the circumstances.

## **5.3 Cost recovery events for assumed scenarios**

### **5.3.1 Scenario one**

Enduring Energy operates in NSW, supplying electricity to 10 000 small customers. Enduring Energy is unable to pay its debts. Due to failure to comply with a statutory demand, an order to wind up the company is made. This triggers a RoLR event and the default RoLR in each distribution area is taken to be the designated RoLR for the event.<sup>27</sup>

Given the RoLR event is localised and the small size of the failed retailer makes it unlikely to threaten the security or integrity of the market, the AER considers customers of the failed retailer should pay a greater portion of the costs. This can be achieved through a cost recovery scheme comprising an upfront fee and the distributor payment determination.

The upfront fee would recover the administrative costs associated with the transfer of customers from the failed retailer to the default RoLR. The AER considers limiting the upfront fee to administrative costs prevents onerous financial obligations being placed on small customers.

The distributor payment determination would be used to recover other associated RoLR costs such as incremental energy costs not covered by the RoLR retail tariff, costs paid to the insolvency official and service order costs. Given the small size of the retailer failure, the distributor payment determination will be limited to distributors operating in NSW.

### **5.3.2 Scenario two**

Optimal Power operates in Victoria, supplying gas to 8 000 small customers. Spitfire is a registered gas RoLR with a firm offer of up to 2 000 small customers and has agreed in advance to forego cost recovery. Optimal Power is unable to meet its prudential requirements and AEMO suspends its right to trade. This triggers a RoLR event. The AER appoints Spitfire as a designated RoLR for 1 850 small customers in one gas network,<sup>28</sup> with the default RoLRs in the other gas networks being the designated RoLR for the remaining 6 150 small customers.

A similar cost recovery arrangement for scenario one for the default RoLRs would be considered appropriate by the AER. As Spitfire has agreed not to recover costs, it is

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<sup>27</sup> s. 132(1) National Energy Retail Law.

<sup>28</sup> s. 132(2) National Energy Retail Law.

prevented under s. 165(5) of the Retail Law from seeking to recover costs. However, the default RoLRs could recover their costs.

### **5.3.3 Scenario three**

Equitable Energy operates in South Australia and Victoria supplying electricity to 40 000 customers and gas to 35 000 customers. Continuing systemic non-compliance with the Retail Law and Retail Rules by Equitable Energy, which the AER has been unable to resolve through administrative and court enforceable undertakings, leads to the AER revoking its retailer authorisation. This triggers a RoLR event. Prior to the revocation of its retailer authorisation, the AER has enquired with registered RoLRs about being appointed a designated RoLR. Ozzie Power, Dynamic Energy, Frontier Power, Magnificent Power, Focus Energy and People Power have agreed they will only recover the administrative costs of transferring those customers. As a result of the enquiries, the AER appoints the following designated RoLRs:

- Victoria: Ozzie Power is appointed the designated RoLR for 10 000 electricity customers and 8 000 gas customers, Dynamic Energy is appointed the designated RoLR for 12 000 electricity customers and Frontier Power is appointed the designated RoLR for 15 000 gas customers.
- South Australia: Magnificent Power is appointed the designated RoLR for 10 000 electricity customers, Focus Energy is appointed the designated RoLR for 8 000 electricity customers and People Power is appointed the designated RoLR for 12 000 gas customers.

The AER considers an appropriate cost recovery scheme would either be an upfront fee or a retail tariff variation to recover the transfer costs. The AER considers this appropriate as the RoLRs have agreed to carry the majority of costs. Also, as the RoLR event was due to systemic non-compliance by management and does not threaten the integrity of the energy market, in this context, costs should not be spread over a wider customer base. In this instance it would be appropriate if the customers of the failed retailer bear the costs. A retail tariff variation would be favoured over an upfront fee if the upfront fee was considered onerous for small customers. The AER notes that the timing of the application and customer composition may be a consideration in deciding whether a retail tariff variation is used to recover costs. The RoLR deemed small customer retail arrangements, over which the AER has the power to vary prices,<sup>29</sup> only last for three months.<sup>30</sup>

### **5.3.4 Scenario four**

Eternal Energy operates in Queensland, NSW and Victoria, and supplies electricity to 100 000 customers, of which 25 per cent are large customers. Oak Energy is a registered RoLR in NSW with a firm offer for 10 000 large customers and Fundamental Power is a registered RoLR in Queensland with a firm offer for 6 000 large customers.

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<sup>29</sup> s. 145(4) National Energy Retail Law.

<sup>30</sup> s. 147(3) National Energy Retail Law.

Eternal Energy is in financial difficulties, due to recent wholesale market volatility increasing its prudential requirements and debts owed to trade creditors and unpaid network charges. Eternal Energy's directors place the company in voluntary administration. This triggers a RoLR event. The AER appoints the following designated RoLRs:

- Queensland: Fundamental Power is appointed the registered RoLR for 589 500 large customers, with the remaining 24015 customers in Queensland being picked up by the default RoLR for each retail/distribution area.
- NSW: Oak Energy is appointed the registered RoLR for 9 521 large customers, with the remaining 30 479 customers in NSW being picked up by the default RoLR in each distribution area.
- Victoria: The 30 000 customers in Victoria are picked up by the default RoLR for each local retailer area.

The AER considers an appropriate cost recovery scheme would be for cost recovery to occur through the distributor payment determination levied amongst distributors across the three jurisdictions. Given the size of the failed retailer may lead to significant RoLR scheme costs (i.e. energy purchase costs) being incurred by designated RoLR's, the AER considers the costs of the RoLR event be spread across a wide customer base to minimise the cost impact of the RoLR event on all market participants. The AER may also consider the use of combined upfront free and distributor payment determination to recover RoLR scheme costs.

The AER considers this is supported by the size of the failed retailer, which may mean costs are quite significant, its operation across multiple jurisdictions and the need to minimize the cost impact of a RoLR event on all market participants.

## Appendix A—Information from a failing retailer

This appendix sets out the information the AER may seek from a retailer,<sup>31</sup> to assist it to decide which registered RoLR should be appointed as the designated RoLR. The information requested may vary depending on the circumstances of the failure. Some or all of the information included for guidance below may be included in the request and the information which may be requested is not limited to what is outlined below.

### Company structure, contractual arrangements and financial position

1. Information on the current ownership structure of the business.
2. A copy of the retailer's standard contracts.
3. A description of the financial position of the business as at the date of response with reference to the ability of the business to continue in the immediate future without triggering one or more of the RoLR event criteria including:
  - a. details of any parent company guarantees
  - b. details of cash flow
  - c. details of amounts owing to distributors
  - d. details of amounts owing to other debtors
  - e. any legal claims which have been made which may affect the businesses ability to satisfy the RoLR event criteria in the future
  - f. details of the current financial position together with the most recent financial statements of the retailer.

### Customer information

4. Total customer numbers split between large and small customers (*example—small or large NMIs*).
5. Total customer numbers split between geographic area (*example—NEM jurisdiction*).
6. Customer load for a specified period split between consumption of large and small customers.
7. Identification of customers in the process of registering with the retailer or transferring away.

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<sup>31</sup> In accordance with its contingency event powers under Division 3 of Part 6 of the National Energy Retail Law.

**Gas arrangements**

8. Details of any shippers with whom the business has made contractual arrangements for the shipping of gas.

## **Appendix B—Registered RoLR tender information**

This appendix sets out the information that the AER is likely to request of registered RoLRs under s. 130(5)(a) of the Retail Law if it believes there is a risk of a RoLR event and there is time before the event to seek the information. Some or all of the information included for guidance below may be requested and the information which may be requested is not limited to what is outlined below.<sup>32</sup>

### **Customer numbers, tariffs and costs**

1. The number of customers which the business is willing to be appointed as the designated RoLR for.
2. For electricity, the class of customers which the business is willing to be appointed as the designated RoLR for.
3. Provide the standing offer terms and conditions including prices which the business would charge electricity and /or gas (as relevant) customers.
4. Provide the terms and conditions including prices which the business would charge electricity and /or gas (as relevant) customers.
5. State if the business:
  - a. agrees to waive its rights to recover RoLR event costs under a RoLR cost recovery scheme under the Retail Law
  - b. wishes to otherwise vary its RoLR cost recovery scheme under the Retail Law (for example by fixing an amount of costs it can recover).

### **Energy sourcing arrangements**

6. Provide details of the arrangements the business currently has to source electricity and/or gas (as relevant) to:
  - a. continue supplying existing customers
  - b. supply the customers it has specified it is interested in.

### **Credit cover arrangements (wholesale market and network)**

7. Explain how the retailer would be able to meet its credit cover requirements for the customers it has specified interest in. If extra credit cover would be required, provide details of how quickly any additional security could be arranged and put in place.

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<sup>32</sup> The AER may provide a standard form for this information to be submitted on at the time of a RoLR event.

# Glossary

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call notice	Has the meaning given by s.10 of the National Electricity Rules.
default RoLR	Has the meaning given in s. 122 of the National Energy Retail Law
designated RoLR	Has the meaning given in s. 122 of the National Energy Retail Law
margin call	With respect to the Declared Wholesale Gas Market, has the meaning given by s.200 of the Gas Rules. With respect to the Short Term Trading Market, has the meaning given by s.364 of the Gas Rules.
registered RoLR	Has the meaning given in s. 122 of the Retail Law.
small customers	Has the meaning given by s.5 of the Retail Law.
standing instruction	Is a notice from the AER to AEMO setting out the electricity and gas default RoLRs and the RoLRs in the event of a first tier retailer failure.
	Has the meaning given by s.10 of the Electricity Rules.
suspension notice	With respect to the Declared Wholesale Gas Market, has the meaning given by s.200 of the Gas Rules. With respect to the Short Term Trading Market, has the meaning given by s.364 of the Gas Rules.

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