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By email: AERInquiry@aer.gov.au

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AER issues papers—Retailer of last resort

Dear Mr Leuner

Jemena appreciates the opportunity to comment on matters in the three AER issues papers released in November 2010. These deal with the AER's role in the retailer of last resort (**RoLR**) scheme established under part 6 of the National Energy Retail Law (**NERL**).

Jemena's detailed response to the AER's request for review and comment is set out in **Attachment 1** and has been prepared as quickly as practicable.

Jemena directly owns Jemena Gas Networks in NSW (**JGN**), the largest individual gas distribution network in Australia, and Jemena Electricity Networks in Victoria (**JEN**). Jemena partially owns the United Energy Distribution electricity distribution business in Victoria (34%) and the ActewAGL gas and electricity distribution business in the ACT (50%). These businesses will be individually affected by the distributor RoLR obligations set out in the NERL.

JEN looks forward to participation in the next stages of the AER consultation on RoLR issues. If you wish to discuss the submission please contact Paul Johnston on (02) 9455 1560 or at paul.johnston@jemena.com.au.

Yours sincerely

A handwritten signature in cursive script that reads "Sandra Gamble".

Sandra Gamble
General Manager Regulation and Strategy
Jemena Limited

Attachment:

1. Jemena, *Response to retailer of last resort issues papers*, 22 December 2010

ATTACHMENT 1

AER Issues Papers—Retailer of Last Resort

22 December 2010

1. Introduction and key messages

The three issues papers issued by the AER deal individually with the following matters for which the AER will be responsible whenever the National Energy Customer Framework (**NECF**) is implemented in each jurisdiction:

- RoLR plan development
- RoLR registrations and appointments
- a retailer of last resort cost recovery scheme.

Our submission follows these broad headings in commenting on the AER proposals in the issues papers. However, given that Jemena's distribution assets straddle three jurisdictions and two energy types—gas in NSW and the ACT and electricity in the ACT and Victoria—we have suggested where different arrangements for gas and electricity would be appropriate. Where Jemena generally supports the AER proposals, we have suggested some considerations to improve overall efficiency.

Jemena's key messages are:

RoLR plan development

In Victoria, the Essential Services Commission (**ESC**) has a RoLR manual which the AER proposes to adopt as a template for its own plan, and the Victorian manual appoints electricity distributors as data custodians. Jemena supports continuation of this role for electricity distributors. However, RoLR arrangements for gas in NSW are governed by the *Gas Supply Regulations* and physically administered by AEMO under its retail market procedures (**RMP**). Jemena considers that the role of AEMO as a *de facto* data custodian for gas in NSW should continue.

RoLR registrations and appointments

Much of the AER issues paper is concerned with the practicality of—and criteria for—appointing 'additional' RoLRs (i.e. those additional to the default RoLR).

Jemena submits that increasing the number of potential RoLRs for a single event can lead to administrative complexity and work against decisive and effective action by distributors and other parties in responding to a RoLR event. Our preference is to keep RoLR administrative arrangements as simple as possible.

Retailer of last resort cost recovery scheme

The issues paper canvasses a number of cost recovery mechanisms for the recovery of a RoLR's costs before and after a RoLR event. These comprise either retailer recovery mechanisms or distribution network tariff variations, and the issues paper identifies advantages and disadvantages for each scheme.

Jemena submits that recovering costs via network tariffs is not a 'first best' option, at least when the failed retailer is only small or medium size, and the first option should be to use a retailer cost recovery mechanism. If the retailer were large, then perhaps there is a case for

using network tariffs to modify the disproportionate effects of cost recovery on the failed retailer's customers, as envisaged in the issues paper.

2. RoLR plan development issues paper

2.1 Plan participants

A RoLR plan is essentially a communication device designed to inform affected parties in the lead up to a RoLR event and during and after the event. The NERL defines 'plan participants' to include the AER and AEMO and allows the AER to nominate particular registered RoLRs, particular distributors and other parties as plan participants.

Jemena agrees with the AER's initial proposal that 'plan participants' should include all retailers in a participating jurisdiction, given that any retailer may potentially fail, and also jurisdictional ombudsman, given their pivotal role in communication.

2.2 Regular customer data transfers

Section 149 of the NERL provides AEMO with broad powers to obtain customer information from a failed retailer. The NERL also provides the AER with similar powers. However, the AER's concern in the issues paper is that obtaining information from a failed retailer may be 'problematic' and so a back-up source as a 'data custodian' is advisable.

NSW gas

The issues paper notes that in Victoria, NSW and the ACT, the retail market procedures require gas retailers to provide monthly customer data to AEMO.

In NSW and the ACT, AEMO obtains monthly customer details from gas retailers for the following items:

- customer name and mailing address
- delivery point identifier
- site address
- owner or tenant
- phone number
- customer type (residential, commercial, industrial)
- whether customer is a 'small retail customer' or a 'franchise customer' within the meaning of the relevant legislation
- type of meter reading at delivery point (daily or non-daily)
- network receipt point
- meter data agent
- retailer of last resort.

Jemena therefore considers that AEMO is effectively the custodian of most gas data that would be required by a RoLR in a failure event. AEMO has recently revised a number of its

gas market procedures in NSW and the ACT to take effect when the NECF is implemented in those jurisdictions, and proposes to continue collecting the above information.¹

For NSW and ACT gas, Jemena submits that AEMO should continue to be considered as the data custodian, with perhaps scope for obtaining additional information from retailers such as whether customers are participating in instalment payment plans or hardship arrangements.

The issues paper canvasses whether distributors could be considered as data custodians, and cites NEM arrangements requiring electricity distributors to provide data sets to designated RoLRs upon advice from AEMO. However, given that AEMO is already effectively a custodian for gas customer data, it is unnecessary for distributors to be called upon to perform this task.

NSW has had a long-established established principle that AEMO should hold the primary records of gas market data. Given that AEMO's system is a centralised repository, Jemena submits that this is the most efficient arrangement when dealing with multiple gas distributors.

Victorian electricity

Under Victorian B2B arrangements, retailers provide distributors with updates of customer data at six-monthly intervals.

The ESC's RoLR Manual gives electricity distributors the role of data custodian. They are required to supply customer data to RoLRs should the failed retailer not do so, just as they did during the recent Jack Green failure.

On the other hand, the ESC Manual nominates VENCORP (now AEMO) as the data custodian for gas, and this is entirely consistent with the position Jemena supports for gas in NSW and the ACT.

Given that Victorian electricity distributors have been appointed as data custodians, and have already acted in a RoLR event, Jemena supports distributors continuing in this role.

3. RoLR registrations and appointments issues paper

3.1 Appointment of multiple RoLRs

Division 2 of the NERL deals with the registration of default RoLRs, and the (potential) registration of 'additional' RoLRs (i.e. additional to the default RoLR).

Division 4 deals with:

- the appointment of a designated RoLR for a RoLR event
- the (potential) appointment of additional RoLRs for (the same) RoLR event.

As the issues paper observes, the key difference between gas and electricity in these matters is that the NERL requires the AER to appoint and register a default RoLR for electricity in respect of each connection point, while for gas the AER must register and appoint a default RoLR only for each distribution system. Thus, unlike gas, the AER can appoint multiple RoLRs for the same electricity distribution system, although each serving different connection points. This concept does not apply in gas.

¹ AEMO Discussion Paper, *Implementation of NECF Retail Market Procedures (NSW and ACT) Changes*, GMI reference IN038/10, 30 November 2010, p. 15.

Much of the AER issues paper is concerned with the practicality of—and criteria for—appointing ‘additional’ RoLRs, given that the NERL requires the AER to make these appointments in accordance with AER guidelines.

From an electricity distributor’s perspective, appointing an excessive number of ‘additional’ RoLRs for a given distribution system could lead to inefficiencies in the customer transfer process during a RoLR event. Dealing with multiple retailers will complicate the distributor’s role under the AER’s proposed RoLR plan²—for example, coordinating information flows to RoLRs at the time of a RoLR event and in providing final or estimated meter readings for the failed retailer’s customers.

Jemena agrees with the issues paper’s initial view that in the terms of event management, the simplest solution would be to appoint as few RoLRs as possible³. But the paper then develops a number of caveats, including that retail competition will be best served by allowing the smaller retailer to increase its market share.⁴

Jemena agrees that competition is an issue, but suggests that that in an emergency event, it should not be the primary issue.

When a RoLR event occurs, the industry needs to act decisively and effectively. Given that that there may be very limited time for the AER to select an alternative retailer or retailers, and to be fully confident of their technical, financial and prudential suitability, it cannot be assumed that the appointment of an alternative retailer or retailers will provide the same level of customer protection as a default retailer.

3.2 RoLR registration criteria

Section 123 of the NERL sets out the criteria for registration as a RoLR, and one of these criteria is financial resources. Jemena welcomes the issues paper’s inclusion of a retailer’s prudential situation as part of the financial criteria to be considered by the AER. Jemena submits that the prudential examination should extend to how close the retailer is to existing credit limits in respect of its distributor obligations, and not just its obligations under AEMO market rules. Jemena would be concerned if the AER were to examine retailers’ prudential situations solely with respect to AEMO and not the distributors.

Jemena agrees with the issues paper’s observation that “a retailer’s prudential situation at the time of registration will likely be different to its prudential situation at the time of a RoLR event”.⁵ Jemena submits that this supports our view that the appointment of multiple RoLRs is likely to increase administrative complexity, and should be handled cautiously.

3.3 Review of RoLR registration

The NERL sets out the AER’s powers for terminating a RoLR’s registration. Jemena agrees with the issues paper that the AER should periodically review RoLR registrations against the criteria in the NERL. The issues paper proposes the following review timelines⁶:

- default RoLRs—every three years
- additional RoLRs with non-firm offers—every two years
- additional retailers with firm offers—every three months

² AER Issues paper: *RoLR plan development*, November 2010, p. 22.

³ AER Issues paper: *RoLR registrations and appointments*, November 2010, p. 29.

⁴ *Ibid.*

⁵ AER, *op. cit.*, p 15.

⁶ AER, *op. cit.*, p 26.

Jemena supports a 3 year review period for default retailers. Increasing the number of reviews means additional cost to a retailer and ultimately to customers.

Jemena submits that review 'trigger events' should include notification to the AER by AEMO or distributors of a RoLR who is very close to its credit limits. If a RoLR is meeting the AEMO prudential requirements but is having difficulty paying a distributor, then this should also be a trigger for a review.

Since the issues paper is proposing that 'additional retailers with firm offers' would put forward those offers for a fixed period (the paper suggests three months⁷), then each renewal of the offer is automatically a review date. However, Jemena questions the likelihood of a significant number of non-default firm offers materialising, given that this is an untried concept in a market dominated by large players.

4. Retailer of last resort cost recovery scheme issues paper

4.1 Background

Section 166(1) of the NERL provides that the AER, upon application by a RoLR, must determine a cost recovery scheme.

Section 166(3) of the NERL identifies two types of costs under a RoLR scheme:

- costs incurred in preparing for a RoLR event (default retailer only)
- costs incurred on and after a RoLR event (default and additional retailers)

The issues paper discusses these two types of costs in detail, noting that a RoLR may incur additional operating costs in a RoLR event which may not be factored into the retailer's standing offer price⁸.

The issues paper observes that all these costs could be determined on an ex ante or ex-post basis, discusses the pros and cons of each approach, and observes that both NSW (IPART) and Victoria (ESC) adopted an ex ante basis⁹.

Finally, the issues paper discusses potential cost recovery mechanisms, namely¹⁰:

- *an up-front (ex ante) fee*—charged to customers of the failed retailer.
- *a retail tariff variation*—this allows a RoLR to obtain an additional margin from customers of the failed retailer, and could be ex ante or ex post.
- *a distribution network tariff variation*—the distributor varies its tariffs so as to recover the costs as a pass through from all network users. This could also be ex ante or ex post.

The issues paper seeks stakeholder views on these cost recovery mechanisms, or any other appropriate mechanisms. Jemena offers its views below.

4.2 Retailer upfront fee

⁷ AER, op. cit., p 21.

⁸ AER, *Retailer of last resort cost recovery scheme issues paper*, November 2010, p 18.

⁹ AER, op. cit., pp 21-22 and Appendix A.

¹⁰ AER, op. cit., pp 24-26.

Jemena agrees with the issues paper that an upfront RoLR fee is the simplest and quickest method of cost recovery, and Jemena notes that this method has worked in Victoria in previous RoLR events.

The issues paper cites some disadvantages of an upfront fee:

- it may unfairly penalise customers of the failed retailer
- it may stifle long term competition, as customers may be unwilling to sign with a new market entrant for fear of RoLR fee in the future.

Jemena does not discount these possibilities, but they must be kept in perspective. Cost recovery for a small failed retailer is unlikely to have detrimental effects on either existing customers or future competition, and quick and simple recovery of costs is a desirable outcome.

There is also an issue of correct market signalling in a RoLR event. If consumers have been the beneficiaries of low pricing from a (failed) retailer, arguably they should also recognise the risk that has accompanied that pricing, and so bear a reasonable amount of the RoLR cost recovery.

The issues paper observes that an upfront fee is not suitable for recovering a RoLR's preparation costs, as it is not clear who this fee should be charged to¹¹. However, the issues paper had earlier cited a number of reasons to suggest that preparation costs would not be a major consideration¹²:

- many state based RoLR cost recovery schemes have not allowed for the recovery of preparation costs
- consultants to the MCE noted that the majority of stakeholders considered that the upfront costs associated with appointment as a RoLR would be minimal
- preparation costs would be confined only to those costs directly related to the RoLR obligation, and would not include any business as usual costs.

Jemena agrees that these are valid indications that preparation costs may not be large.

4.3 Retail tariff variation

In this version of cost recovery, the RoLR charges customers of the failed retailer the standing offer price plus an additional margin for a set period. While this method offers the prospect of reasonably quick cost recovery, the issues paper discerns similar disadvantages to that of an upfront fee. Additionally, the paper says higher RoLR tariffs may encourage customers to transfer to another retailer.

Again, while not discounting these possibilities, Jemena notes that they should not be significant for a small retailer failure. Jemena also understands that some jurisdictional rules prevent customers being transferred while they are indebted to a retailer (e.g. the Victorian Electricity Customer Transfer Code).

4.4 Distribution network tariff variation

¹¹ AER, op. cit., p. 25.

¹² AER, op. cit., pp. 15-16.

Section 167 of the NERL provides that any payments made to a retailer by a distributor as part of an AER 'RoLR cost recovery scheme distributor payment determination' are taken to be:

- *In the case of electricity*—positive pass through amounts approved under the NER
- *In the case of gas*—approved cost pass throughs allowing variation of the distributor's reference tariffs.

This NERL provision opens the possibility of using network tariffs to recover the RoLR's costs. The AER issues paper suggests that there are a number of positives in using this method of recovery¹³:

- it allows the costs of the RoLR event to be recovered from a much broader customer base
- the burden of cost recovery by individual customers is much smaller
- the RoLR may have a better chance of recovering all of its costs.

The issues paper also sees a number of operational disadvantages with recovery via network tariffs. This mechanism is likely to take the longest time compared to other cost recovery mechanisms and may not be as administratively simple as an upfront fee.

Jemena agrees that recovery through network tariffs does suffer from the particular disadvantages noted above, but is not so convinced about the benefits cited in the issues paper.

If distributors are given the role of recovering RoLR costs from all network users, then they effectively are functioning as a market operator. In a RoLR event, AEMO has the roles of arranging for the orderly transfer of one set of customers from one retailer to another, and arranging for the disconnection of those who are not transferred. AEMO would recover its own costs of these activities from market participants. Jemena submits that RoLR costs—if they are to be spread around the market as the issues paper apparently envisages—are no different in kind to the other RoLR costs incurred by AEMO. In Jemena's view, there is compelling logic in having AEMO recover RoLR costs, and this recovery could be faster and much simpler than varying network tariffs. See section 4.5 below for an example of where AEMO does recover some particular NSW RoLR costs through its market operator costs

Unfortunately, the NERL makes no provision for allowing AEMO to recover RoLR costs. In Jemena's view, this was an opportunity missed, but we recognise that this is a design feature in the NERL outside the AER's control

Jemena submits that recovering RoLR costs via network tariffs is not a 'first best' option, at least when the failed retailer is only of small or medium size. The first option should be to use a retailer cost recovery mechanism. This reflects the consideration in our section 4.2 above, that the failed retailer's customers should bear a reasonable amount of the RoLR cost recovery. If the retailer were large, then perhaps there is a case for using network tariffs to partly offset the disproportionate effects of cost recovery on the failed retailer's customers.

Jemena notes that the issues paper's discussion of network tariff variation makes no mention of how the AER envisages the pass through mechanisms working in relation to electricity price determinations and gas access arrangements. Jemena would be seriously concerned if the AER proposed that distributors should pay the RoLR for its costs (either ex ante or ex post) in the short term but then delayed distributor pass-through for a considerable period. In

¹³ AER, op. cit., p. 26.

gas, this could be up to a year under a reference tariff variation mechanism. While there should certainly be some mechanism for recovering money time value in distributor pass throughs, a large RoLR event could cause real short term funding problems for a distributor.

Jemena submits that the AER should amend its 'cost recovery factors' in section 4.2 of the issues paper (dot point three) to state that that " the approach should not compromise the financial positions of either RoLRs or distributors".

The issues paper raises a number of issues with distributor payments, including which distributor or distributors should make the RoLR payments. The paper seems to contemplate that if the customers of the failed retailer were spread among various networks, then all networks should contribute. But Jemena submits that realistically there should be a percentage rule to minimise administration costs. For example, if (say) 80 per cent of the failed retailer's customers were confined to one network, then the network tariff variation should be confined to that network.