Terms of Reference

Review into the arrangements for failed retailers' electricity and gas contracts
RPR0016

Overview

Under Division 5, section 232 of the National Energy Retail Law (NERL), the Australian Energy Market Commission (AEMC or Commission) has initiated a review into the operation of the rules relating to electricity and gas hedging contracts held by failing retailers (the Review).

The Review seeks to:

1. identify ways in which the Retailer of Last Resort (RoLR) scheme may be improved, to potentially facilitate access to these or equivalent hedging arrangements by a designated RoLR that is required to receive the failed retailer's customers, and
2. analyse the recent conduct of retailers encouraging their customers to change retailers during this period of volatile market conditions to determine if regulatory changes are needed to better protect customers.

The AEMC is initiating the Review as part of a broader suite of recommendations put forward to energy ministers to enhance financial resilience in the context of volatile market conditions and a record number of RoLR events. The broader reform program includes scenario planning, exploring government-owned retailers registering as RoLRs and enhancements to the RoLR scheme.

What is the Retailer of Last Resort scheme?

In the event of a retailer failure, the RoLR scheme is the mechanism that facilitates the orderly transfer of customers of the failed retailer to a new retailer (designated RoLR) to prevent disruption of electricity or gas supply to those customers. A RoLR event may be triggered by a number of events or circumstances including a retailer going into receivership or becoming insolvent, failing to meet its prudential requirements, or ceasing to be a market participant.

When a retailer fails, its customers are allocated to a designated RoLR. However, while the customer relationship is transferred (together with an obligation to maintain supply to those customers) the contracts that the failed retailer relied upon to manage price risk associated with supply to customers do not transfer with them. In volatile market conditions with high wholesale prices (record prices in the recent energy crisis), the designated RoLR may face financial stress from being exposed to high spot prices or hedging costs for its new customers. In extreme circumstances, this could trigger cascading retailer failures. In addition to placing stress on the designated RoLR, this may result in higher costs to customers because the RoLR arrangements allow the RoLR to pass on costs from a RoLR event to customers.

Current market conditions have prompted the AEMC to self-initiate this review

Wholesale electricity prices have been rapidly increasing due to a range of factors. There has also been a considerable amount of price volatility in wholesale electricity and gas markets. This has resulted in a period of heightened risk across multiple parts of the supply chain.

Until recently, the RoLR provisions were rarely relied upon. However, in the period from 24 May to 1 September 2022:

- seven authorised retailers have failed and triggered RoLR events – Weston Energy in gas, and Pooled Energy, Enova Energy, Powerclub, Mojo Power East (also trading as People Energy), Social Energy and Elysian in electricity
- Apex Energy (an exempt seller within embedded networks) recently entered administration.

In this period, we also observed some unusual retailer behaviour with some actively encouraging customers to change retailers. At the same time, some designated RoLRs experienced difficulty accessing contracts to service their new customers.

Objective and scope

The objective of the Review is to determine if changes can and should be made to the energy laws and rules to minimise the risks that designated RoLRs face and the costs that customers incur following RoLR events. This may occur where the designated RoLR is exposed to risks from customers they had not planned or hedged for and may pass this cost onto customers.

To meet this objective, the AEMC will:

- explore whether and how designated RoLRs may access hedging contracts for electricity, gas and pipeline capacity from the failed retailer in a timely and cost-effective manner (given that any transfer of customers and supply obligations occurs quickly and, often, with little warning or notice). In the context of electricity and gas retailers, this includes:
  - the nature and scope of gas supply and pipeline capacity directions including whether the 3-month AER directions set out in s. 137 of the NERL are appropriate and adequate
  - access to electricity hedging contracts through the exchanges and over the counter available to designated RoLRs, and the adequacy, timeliness and cost-effectiveness of access to hedges through these means on short notice.
- consider the potential for principles or requirements to apply under which new hedge contracts must include terms and conditions to allow the designated RoLR to purchase contract(s) on reasonable terms.
- analyse actions of retailers encouraging their customers to change retailers, including large changes in prices offered to customers and unusual contract market activity including indications that these retailers then subsequently sold hedge contracts for significantly more than they were purchased for. If the analysis reveals this behaviour was not in the long-term interest of customers, the Commission may consider whether regulatory changes are needed to protect customers.
- identify possible changes to the energy law and rules, including any roles or powers the AER may need to enforce any feasible policy solutions.

The review will consider National Energy Customer Framework jurisdictions. Victoria has a separate RoLR scheme and is outside the scope of this work. However, the AEMC will consult and liaise with the relevant organisations in these jurisdictions including the Victorian Department of Environment, Land, Water and Planning on the Review.

The Commission notes that because of the interrelationship between the RoLR scheme and insolvency laws, the Review may identify policy solutions that require implementation through legislation other than the energy laws and rules.

In August, Energy Ministers agreed on 12 recommendations put forward by the AEMC to improve the RoLR scheme and enhance the financial resilience of the energy market to large retailer failures. The recommendations included scenario planning to prepare for crises, exploring government-owned retailers registering as a RoLR to be used as a last-resort measure, enhancements to the RoLR scheme and this review. Therefore, the scope of the Review does not include the operation of the RoLR scheme beyond the issues relating to the access to or costs associated with electricity hedging instruments, gas supply, pipeline capacity and storage.

Consultation and Engagement

In conducting the Review, the AEMC will engage a broad range of stakeholders including:

- the Australian Energy Regulator (AER), which is responsible for issuing directions for gas supply and pipeline capacity and enforcing the RoLR regime
- the Australian Securities and Investments Commission (ASIC), given the intersections with insolvency law
- the UK Office of Gas and Electricity Markets (Ofgem), which is currently undertaking a review, *strengthening retail financial resilience,* that explores similar issues in the UK retail sector
- ASX, FEX the Australian Financial Markets Association
- the Essential Services Commission of Victoria
- relevant State, Territory and Commonwealth officials
- retail and wholesale market participants in gas and electricity.

Deliverables and timing

The AEMC will undertake the Review in two stages. In stage one, the AEMC will identify what policy options are available to address the matters within the scope of the Review and the relevant law and/or rule changes that may be required to achieve them.

At a minimum, the AEMC will publish two reports during stage one:

- a consultation paper in October 2022
- a stage one final report after briefing Energy Ministers in December 2022.

If stage one of the Review identifies feasible policy options, then the AEMC will commence stage two of the Review in 2023. Stage two will address the implementation of feasible policy options identified in stage one.