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**10 November 2022**

***Review into the arrangements for failed retailers' electricity and gas contracts: Consultation paper***

AGL welcomes the opportunity to provide our response to the *Review into the arrangements for failed retailers' electricity and gas contracts: Consultation paper* (Consultation paper) released by the Australian Energy Market Commission (AEMC) on 13 October 2022.

AGL operates nationally across the energy supply chain and delivers 4.2 million gas, electricity, and telecommunications services to our residential, small and large business, and wholesale customers across Australia. We operate Australia's largest electricity generation portfolio, with a generation capacity of over 11,000 MW, accounting for approximately 20% of the total generation within Australia's National Electricity Market.

AGL is registered as a default Retailer of Last Resort (ROLR) for both gas and electricity in various jurisdictions and has been the designated ROLR in numerous instances of retailer failure. Our experiences in these ROLR events have clearly highlighted the risks that retailer failure can place on the designated ROLR and has seen AGL elect not to, or withdraw from, being registered as a default ROLR in several jurisdictions.

Previous reviews of the ROLR framework have focussed on the administration of a ROLR event and only provided limited recovery of these process costs. The potential wholesale cost impact has been either assumed to be manageable by the designated ROLR or too complex to address through regulation.

AGL is therefore pleased to see the AEMC initiate this review and explore opportunities to reduce the wholesale risks faced by a designated ROLR.

AGL believes that in this review the AEMC needs to focus on ensuring that:

- a designated ROLR is able to recover the full cost of the ROLR event, including wholesale costs, in a timely manner; and

- there are no commercial incentives for a retailer to voluntarily enter into a ROLR event and that any residual value held by a failed retailer is used to defray the cost of the ROLR that is born by customers.

Addressing these concerns will go a long way towards mitigating the AEMC's overarching concern regarding the risk of a cascading retailer failure.

We note the Consultation paper seeks stakeholders' experiences in recent ROLR events and subsequently views on how the ROLR framework can be improved to mitigate the risks to designated ROLRs. The AEMC has also proposed many potential options that could address the problem but are complex to implement and therefore seeks feedback initially on which solutions it should focus on.

AGL's detailed responses to the options proposed and questions raised in the Consultation paper are included in Attachment A.

However, in summary, AGL believes that:

- The current gas framework allows for directions to be made by the Australian Energy Regulator (AER) to enable a designated ROLR to access gas supply and pipeline capacity under contracts held by the failed retailer. The Consultation paper questions whether these directions should be expanded and clarified. AGL's recent experience as the designated gas ROLR for Weston Energy identified that these directions are poorly framed, open to legal challenge and insufficient to effectively address a gas ROLR event.

The gas directions therefore need to be largely rewritten rather than simply amended and clarified.

- The Consultation paper proposes four potential options to explore regarding an electricity ROLR event and treatment of wholesale electricity costs. While AGL sees merit in all the proposed solutions, we feel the legal complexities of implementing a directions framework to allow for transfer of the electricity contracts from a failed retailer to the designated ROLR may be insurmountable.

As such, AGL supports the AEMC focussing on improving the cost recovery mechanism for ROLR events to ensure it encompasses all the wholesale costs incurred by the designated ROLR. This includes exploring how the timing of any cost recovery may be improved and specifically, how any residual contract value held by the failed retailer can be accrued and distributed to the ROLR and consequently, its customers.

Furthermore, as mentioned above, AGL believes the issue of how to deter retailers from voluntarily triggering a ROLR event just because it is in their commercial interest should also be a focus point of this AEMC review.

We believe this can most effectively be achieved by a retailer needing to be insolvent prior to being able to trigger the ROLR regime combined with a regulation that effectively transfers the benefit of any wholesale contracts (in gas or electricity) to the ROLR. AGL understands this is the situation in the United Kingdom (UK) retail market and this ensures that any struggling retailer chooses to explore all options to deal with its customers and its commercial circumstances, in effect a 'pre-ROLR' process, rather than simply default and enter into the UK's own ROLR scheme.

We recognise the Consultation paper does not specifically consider this issue and the narrowing of the triggers for a ROLR event may lie outside this specific consultation.



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However, the AEMC can look at other ways to disincentivise this type of behaviour by choosing solutions from its Consultation paper that ensure that a failed retailer cannot keep the value of its wholesale contracts. If any contract value is effectively captured and dispersed to the designated ROLR and impacted ROLR customers rather than retained by the failed retailer, then retailers are unlikely to voluntarily choose to fail and enter the ROLR scheme.

Although this Consultation paper is limited to wholesale matters, AGL is expecting other concerns with the ROLR framework to also be reviewed in the near future including:

- conditions that could be placed on retail market entry and authorisation to minimise the risk and cost of ROLR events;
- restricting retailer failure to insolvency conditions as highlighted above; and;
- improving the ability for retailers to utilise a 'pre-ROLR' process which would allow retailers to resolve commercial issues without formally entering a ROLR event. We expect this would allow for an improved customer experience.

If you have any questions in relation to this submission, please contact Patrick Whish-Wilson on [pwhish-wilson@agl.com.au](mailto:pwhish-wilson@agl.com.au).

Yours sincerely



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## **Attachment A: AGL Responses to the Consultation paper**

### **Nature of the problem for failed retailers' electricity and gas contracts**

#### Electricity contracts

AGL agrees that the risk of being a designated ROLR and receiving an unexpected number of customers and amount of unhedged load is material, as has been demonstrated over the ROLR events of this year. These events have occurred in times of very high contract and spot prices which is naturally when most ROLR events are expected to occur.

Following a retailer failure and in a period of high wholesale prices, such as currently experienced, the designated ROLR is faced with uncertainty about the additional customer load due to slow and poor information flow from the failed retailer to the designated ROLR and either:

- purchases hedging contracts at elevated prices to cover an estimated load; or
- remains exposed to the volatile wholesale spot prices.

These circumstances can result in the costs of servicing the ROLR customers being above the Default Market Offer (DMO).

Even where the designated ROLR is long on contract cover and therefore able to absorb the additional load of the ROLR event, in periods of high prices the designated ROLR would still be financially worse off using its contract cover to supply this unexpected customer load.

Although the designated ROLR can apply to the AER for limited cost recovery associated with a ROLR event, this does not cover these wholesale costs and there is no mechanism for the ROLR to obtain the contracts of the failed retailer under the electricity framework.

In AGL's experience, the only way for retailers to currently mitigate the risks of ROLR events is electing to not be registered as a default ROLR.

#### Gas Contracts

The current AER ROLR gas directions are set out in section 137 of the NERL and are supposed to, in principle, enable the designated ROLR to have access to gas supply and pipeline capacity contracted to the failed retailer for the purpose of servicing transferred customers on short notice.

This was not the case in practice as AGL found during its recent experience as the designated gas ROLR for Weston Energy. This ROLR event occurred during a period of unprecedented high gas prices and the AER's directions were intended to provide access to competitively priced gas. Unfortunately, the directions under section 137 were unclear and ineffective in addressing such a significant gas ROLR event.

AGL found that:

- the regulations appear to complicate and delay the AER's ability to make a direction under section 137. AGL would suggest the AEMC seek the AER's input as to the complexity of this decision-making process and whether the regulations should provide a more binary basis for that direction power to be enlivened;
- the directions were complicated by nature of the ROLR event being caused by a default condition rather than insolvency of the failed retailer – Weston Energy was not insolvent;

- good faith negotiations between the designated ROLR and each gas producer to negotiate a new contract or novate the existing contract were frustrated by the inclusion of the failed retailer in the negotiations process; and
- the value of a gas supply contract in times of high gas prices incentivises the failed retailer to attempt to retain ownership of such contracts. The interpretation of section 137(12) of the NERL advocated by Weston Energy, and not contested by the AER, only provided for the directions to be in place until a contract is novated or replaced, or until the three-month period comes to an end. This interpretation allowed Weston Energy to auction off the remainder of the gas supply contracts at the end of the three-month period.

Based on this recent experience, AGL believes the gas directions framework must be significantly changed to ensure that all relevant gas supply contracts of the failed retailer are provided to the designated ROLR (at its election) so that they may provide the benefit of these gas supply contracts to impacted customers.

In AGL's view, the designated ROLR should also have a clear right to access relevant information in a timely manner. The AER should be able to issue a direction to the failed retailer to make available to the designated ROLR:

- a copy of all of its supply contracts, in both gas and electricity (and in the case of gas, including transport and storage). This would facilitate the ability of the ROLR to determine which of the contracts it needs to be novated to best supply the customers; and
- a comprehensive summary of the failed retailer's customers, and the basis on which they are charged (in particular, whether they are on fixed price contracts). AGL notes that this information could potentially come from AEMO, and we recommend a consultation on the information that is necessary and where it can most quickly and efficiently be sourced from.

### Expanding and improving the current AER directions for gas supply

Under the gas ROLR framework, the Consultation paper questions whether the AER's existing gas directions powers:

- be expanded to include gas storage contracts;
- have a broader trigger to consider market conditions and pricing;
- be increased to a period longer than 3 months;
- are clarified to continue regardless of whether the contract expires during the direction period; and
- include the requirement that all entities negotiate in good faith or with best endeavours to negotiate new contracts.

Although these proposed amendments are beneficial and largely worth pursuing, they are incremental changes that will not resolve the fundamental problem with the current AER's gas directions as experienced by AGL.

AGL believes that the AER gas directions need to allow for the unambiguous and unilateral novation of all relevant gas contracts from the failed retailer to the designated gas ROLR, with the ROLR having the ability to elect to take on these contracts, but the failed retailer not having the ability to frustrate this. This should include any type of contract that is required to provide physical gas supply to these customers

(e.g. supply, storage, capacity and transport contracts). Such an explicit direction should not require any trigger and not require any involvement of the failed retailer, post transfer of the contracts.

Under such a scenario where there is a clear obligation on the failed retailer to novate, AGL believes the three-month period to negotiate any other necessary contracts should be sufficient. AGL's recent experience was that the gas producers were very willing to negotiate in good faith in relation to both the novation and/or a replacement gas supply contract.

However, AGL is happy to see a requirement that all entities in the direction negotiate in good faith or with best endeavours to negotiate new contracts. AGL would also seek requirements in the directions that the benefits of any novated gas contracts are shared in good faith and on a reasonable basis with the gas customers that have transferred across to the designated ROLR. AGL would however warn against this requirement being too formulaic or specific, as the circumstances in relation to each event will be different.

There should also be an obligation to distribute the benefit of the supply contracts amongst customers on a fair and reasonable basis, and a requirement to advise the AER of the manner in which this obligation was met.

## Options for electricity retailing

The Consultation paper lists four separate potential improvements to the issue of wholesale risk under the electricity ROLR framework. AGL believes all options would have positive benefits but supports the use of option 1, which is relatively straightforward, and the further development of option 4 in parallel.

### Option 1

That the review explicitly clarifies that the AER cost recovery process currently available to the designated ROLR includes wholesale and hedging costs.

AGL's previous experience with this process was limited to the recovery of administrative costs prior to and following a ROLR event and we do not believe the current wording would provide the surety on wholesale cost recovery that the AEMC is seeking in this review.

However, this option is clearly a simple one to progress through amendments to the National Energy Retail Law (NERL) and the AER Guidelines to ensure reasonable wholesale costs recoverable during this process.

The only concern with this option is the time required to complete any cost recovery process and the financial burden on the designated ROLR during this time. AGL proposes that:

- the cost recovery provisions are written to provide certainty regarding the ROLR's ability to recover all costs;
- it is very clearly defined how they are to be calculated and measured by retailers;
- this certainty will then allow a designated ROLR to access financing to support their business if needed while awaiting payment under the cost recovery scheme; and
- the cost recovery payments need to be determined and paid as quickly as possible.

### Option 2

That information gathering powers are introduced for the AER to gather all contract details from the failed retailer and share that information with the designated ROLR.

Initially, this simple option does not purport to provide any significant benefit to a designated ROLR and is unlikely to improve their price outcomes relative to the existing arrangements.

However, AGL's recent experiences as a designated ROLR has highlighted the need for timely and accurate information in any ROLR event. Consequently, this contract information gathered by the AER may improve the timeliness of the ROLR's contracting process in certain circumstances. It may also reduce the administrative and regulatory burden on the designated ROLR which is often spending time and resources chasing information from the failed retailer.

This option therefore warrants further consideration and AGL sees no reason why it could not be developed in conjunction with other options that are found to be beneficial.

#### Options 3a and 3b

These options introduce a directions framework where directions are issued to the failed retailer and counterparty to the contract, requiring them to negotiate a new contract with the designated ROLR. While similar to the current gas direction powers, the contracts negotiated under these options could be negotiated with reference to the current market price or to the contracted price.

AGL believes the benefits of such direction powers in an electricity ROLR event would be highly valuable and greatly mitigate the wholesale risks that currently are placed on the designated ROLR. This option also has the benefit that the ROLR can be immediately protected against wholesale costs. This would result in lower overall costs to consumers.

However, AGL's experiences with the gas direction powers, as described above, highlight the difficulty in regulating directions that are suitable and effective in the different ROLR situations. In the electricity market, these difficulties are compounded including:

- can all derivative contracts be legally directed to another party;
- can these and other supply contracts be novated if they breach the counterparty's market risk or credit limits;
- how are any contracts to be novated between designated ROLRs when more than one; and
- what happens to the failed retailer's contract if it is insolvent compared to when it is simply in default?

AGL believes the high complexity required to implement such directions powers in the electricity market with its range of contracts and derivatives makes these options too difficult to progress.

#### Option 4:

This AEMC solution expands on option 1 and introduces a mechanism where any value of the failed retailer's wholesale contracts that can be accessed, is used to pay some or all of the wholesale and contracting costs that the designated ROLR may be awarded through the AER cost recovery process.

As highlighted under option 1, AGL strongly supports the amendment of the AER cost recovery process under the NERL to make it explicit that the cost recovery includes wholesale and/or hedging costs incurred in serving the ROLR customers.

Subsequently, AGL also supports further development of this option which, while highly complicated and difficult to legally frame, is a significant improvement on option 1 as it also focusses on:

- ensuring the value of any contracts is not retained by the failed retailer;

- 
- using any residual value to offset some or all of the costs of the ROLR event; and
  - minimising the cost to consumers who would otherwise be liable for these ROLR costs.

We recognise the implementation of such a mechanism would require changes to legislation outside of the energy sector, including corporations law and insolvency legislation, but are mindful that the UK is pursuing similar reforms to preserve and utilise the value of any failed retailer's contracts.

We note this is a more straight-forward situation in the UK because a retailer can only fail if it is insolvent which simplifies any recovery of contract value. This has the added benefit that retailers strive to avoid a ROLR event.

The additional benefit of the AEMC pursuing this option for electricity ROLR events is that any failed retailer will be responsible for meeting the costs of the ROLR where possible and the incentive for any retailer to voluntarily enter the ROLR scheme will no longer exist.

### Retailer behaviour during volatile market conditions

In its Consultation paper, the AEMC has highlighted some retailer behaviour that it considers unusual and worth questioning with stakeholders whether further action needs to be taken in this, or other reviews.

Some of the specific behaviour related to retailers':

- increasing retail prices in a very short period; and /or
- strongly advising their customers through written communications to transfer to another retailer.

AGL notes that there are already significant consumer protections under both Australian Consumer Law and the National Energy Consumer Framework governing how retailers change price, how they communicate this price change to customers as well as how retailers should represent access to retail prices and products on their websites.

In AGL's experience, the AER regularly monitors compliance of these behaviours and has not indicated that any of the unusual behaviours above were non-compliant.

AGL does not consider any further review or regulatory reform is necessary.