



Your ref: RPR0016

14 November 2022

Ms Sam Markham  
Australian Energy Market Commission  
**Submitted online at:** [www.aemc.gov.au](http://www.aemc.gov.au)

Dear Ms Markham

**Submission: Review into the Arrangements for Failed Retailers'  
Electricity and Gas Contracts**

CS Energy welcomes the opportunity to provide a submission to the Australian Energy Market Commission's (**AEMC's**) Review into the Arrangements for Failed Retailers' Electricity and Gas Contracts (**Review**).

**About CS Energy**

CS Energy is a Queensland energy company that generates and sells electricity in the National Electricity Market (**NEM**). CS Energy owns and operates the Kogan Creek and Callide B coal-fired power stations and has a 50% share in the Callide C station (which it also operates). CS Energy sells electricity into the NEM from these power stations, as well as electricity generated by other power stations that CS Energy holds the trading rights to.

CS Energy also operates a retail business, offering retail contracts to large commercial and industrial users in Queensland, and is part of the South-East Queensland retail market through our joint venture with Alinta Energy.

CS Energy is 100 percent owned by the Queensland government.

**Key recommendations**

CS Energy supports the AEMC's examination of the treatment of failed retailers and ways to address concerns with the existing Retailer of Last Resort (**RoLR**) arrangements. Recent events both locally and internationally have demonstrated the impact market volatility can have on some retailers' continued viability, but the costs of retailer failure should not in the first instance be passed directly or indirectly to the failed retailer's customers or consumers more broadly.

While the Review notes the potential for systemic risks following the transfer of a large number of customers due to retailer failure, CS Energy believes the ability to address this risk is beyond the scope of the current review. Clarifying the treatment of failed retailers'

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contracts and ensuring RoLR provisions are employed only as a last resort rather than for strategic commercial reasons (including making failed retailers responsible in the first instance for incurred RoLR costs) should address concerns with “unusual” retailer behaviour during periods of market volatility and reduce the risk of cascading retailer failures.

However, CS Energy questions whether the reforms proposed in the Review are treating the symptom rather than the cause. Further examination of which voluntary and involuntary retailer exits are classified as RoLR events while maintaining sufficient consumer protections in the event of retailer exit is warranted. For example, making retailer insolvency a pre-requisite for accessing RoLR provisions may be one way of avoiding strategic use of these provisions to achieve commercial outcomes; retailers would still be able to voluntarily exit the market but would not be able to shift the cost of doing so onto other retailers and ultimately consumers via the RoLR provisions.

#### Potential solutions for failed retailers’ electricity contracts

With respect to the treatment of electricity and gas contracts, CS Energy recommends undertaking further work on Option 1 and examining mechanisms that deliver on the intent of Option 4, to determine the expected impacts on the identified issues and the expected costs of feasible options.

CS Energy considers that the legal impediments to implementing Options 2, 3a and 3b are too large to be overcome. These options do not represent a feasible, practical or desirable response to the identified issues with the current RoLR arrangements, and accordingly should not be progressed.

Further discussion of CS Energy’s views of the options presented in the Review is presented below.

#### *Option 1 – Cost recovery clarity*

CS Energy believes Option 1 is a no-regret reform that should be progressed immediately, regardless of the progress on the other options presented in the Review. Clarification of what costs designated RoLRs can recover, particularly whether designated RoLRs can recover wholesale costs incurred in preparing for RoLR events and wholesale costs incurred on or after a RoLR event, is required to ensure all stakeholders have adequate clarity of cost recovery both in advance of and during a RoLR event.

However, the implementation of Option 1 in isolation could result in consumers bearing the additional wholesale hedging costs stemming from retailer failure, which runs somewhat counter to the risk aggregation and risk management roles retailers are supposed to play on behalf of consumers. In order to reduce the burden on consumers, mechanisms that make the failed retailer initially responsible for the marginal costs incurred by the RoLR to reduce the costs recovered from consumers warrant further investigation (acknowledging the sizeable legal and commercial impediments to the implementation of the other options presented in the Review in their current form).

#### *Option 2: Matchmaking service*

CS Energy does not see any benefit in continuing work on Option 2.

It is not clear how providing information on contract positions held by the failed retailer to the designated RoLR would assist if the designated RoLR chose to “go out to market to

*seek to strike contracts with the counterparties of contracts previously held by the failed retailer*".<sup>1</sup> As noted in the Review, not all RoLR events would necessarily trigger a right to terminate (refer to Table 1). In the event the contracts are not terminated, there is no additional "spare capacity" created by the failed retailer's withdrawal from the market to sell to the designated RoLR.

What happens to contracts?	RoLR event trigger
Unlikely to trigger a right to terminate the contract and therefore remain in force	<ul style="list-style-type: none"> <li>• Revocation of retailer authorisation</li> <li>• Suspension of wholesale trading rights</li> <li>• Cessation of sale of energy</li> </ul>
Terminate as a result of the RoLR event	<ul style="list-style-type: none"> <li>• Appointment of insolvency official</li> <li>• Order or resolution for winding up</li> </ul>

TABLE 1: RoLR EVENT TRIGGERS AND CONTRACTS<sup>2</sup>

Even in the event the contracts are terminated, it is not clear how the details of past contracts would be relevant in the event the designated RoLR goes to market, particularly if the failed retailer's counterparties' willingness and ability to enter into new contracts has changed in the interim. For example, higher-than expected market volatility that results in retailer failure could be partially attributable to an unplanned outage in a failed retailer's counterparty's portfolio; high volatility and long unplanned outages would both be expected to curb counterparties' contracting appetite and activity.

There is also the issue of whether a failed retailer's counterparties want to have the details of contracts struck in the past with the failed retailer divulged to the designated RoLR. This is particularly concerning if the designated RoLR is a current or prospective contract counterparty to the failed retailer's counterparties. The risk that contract information may be divulged in the event of retailer failure could dissuade counterparties from entering contracts with retailers they suspect could fail, potentially increasing the likelihood of retailer failure.

The provision of the failed retailer's contract position to the designated RoLR would not improve price outcomes for the designated RoLR. It is not clear how this option would benefit consumers, the failed retailer's counterparties or the designated RoLR. Accordingly, there does not appear to be a justification for the AEMC undertaking further work on Option 2.

*Option 3a - Introduce a directions framework with reference to current market prices; and Option 3b - Introduce a directions framework with reference to contracted prices*

CS Energy does not see any benefit in continuing work on Options 3a and 3b.

The AEMC notes the existence and operation of the existing National Energy Retail Law (NERL) section 137 RoLR gas directions power and seeks to apply a similar methodology to electricity hedging contracts for failed electricity retailers. CS Energy suggests caution must be displayed here; there is a material difference between ensuring continued physical supply of gas and continued financial hedging of electricity load, so alignment between the two must be adequately justified.

As noted in the Review, the primary concern with Options 3a and 3b is that they would rely on *"entities that are not governed by energy laws and rules"*.<sup>3</sup> CS Energy questions the value of suggesting these options before determining whether they could be implemented given the complex interactions between the obligations of energy retailers under energy law

<sup>1</sup> AEMC, [Review into the Arrangements for Failed Retailers' Electricity and Gas Contracts](#), page 23

<sup>2</sup> AEMC, [Review into the Arrangements for Failed Retailers' Electricity and Gas Contracts](#), page 8

<sup>3</sup> AEMC, [Review into the Arrangements for Failed Retailers' Electricity and Gas Contracts](#), page 29

and corporation law. CS Energy considers the expansion of energy law to include non-market participant counterparties or the application of Option 3a or 3b to only market participant counterparties are both undesirable outcomes; the former would introduce greater uncertainty about the current risk management arrangements in the market and may encourage non-market participants to leave the market, while the latter would result in an uneven playing field for market participant counterparties versus non-market participant counterparties.

In the event the failed retailer's contracts are not terminated, the transfer of contracts from the failed retailer to the designated RoLR may result in the failed retailer's counterparties finding themselves contractually bound to retailers they may not have voluntarily chosen to deal with. Further, any transfer of contracts without regard for the existing contractual arrangements between the failed retailer's counterparties and the designated RoLR could result in one or both breaching their market risk and credit limits, potentially increasing the risk of further failures.

CS Energy believes the risks identified with Options 3a and 3b (i.e., complex, difficult to implement, higher costs and risks for market entry, may provide perverse incentives to transfer contracts prior to failure) are substantial and cannot be addressed without materially intruding upon commercial decisions of retailers and their contract counterparties both in advance of a retailer failure and during a RoLR event.

*Option 4 – Use the failed retailer's "in the money" electricity contracts to minimise RoLR cost recovery*

CS Energy supports continued work on developing mechanisms that deliver on the intent of Option 4.

CS Energy believes making the failed retailer responsible for meeting RoLR costs in the first instance rather than consumers may dissuade strategic use of the RoLR provisions, but the concern about a failing retailer transferring contracts prior to failure would need to be addressed. There are also seemingly significant legal and commercial issues with progressing Option 4 as currently proposed.

One of the significant issues is the intention to direct non-market participant counterparties to terminated contracts to pay the remaining contract balance at the point of termination. CS Energy seeks clarification of the legal basis on which a counterparty can be directed to pay the remaining contract balance on a terminated contract. CS Energy does not believe it is appropriate for non-market participants to be directed in the proposed fashion but is concerned about the potential impact of the asymmetric application of these directions would have on the contracting behaviour of market participant counterparties and non-market participant counterparties.

Further examination of other options that deliver on the intent of Option 4 while avoid the challenges with selling the failed retailer's contracts is warranted. However, close attention must be paid to the obligations of retailers under corporation law to ensure consistency between energy law and corporation law for both market participants and non-market participants and safeguard against the RoLR provisions allowing the designated RoLR to leapfrog creditors in the event of retailer failure that concludes with the retailer being wound up.

### Retailer behaviour during volatile market conditions

CS Energy believes retailer behaviour during volatile market conditions needs to be examined to ensure customers are not being adversely affected by retailers strategically using the RoLR provisions to achieve more-preferrable commercial outcomes. To this end, CS Energy suggests the AEMC undertakes further examination of which voluntary and involuntary retailers exits are classified as RoLR events. One way of avoiding strategic use of the RoLR provisions would be to institute retailer insolvency as a prerequisite for accessing the RoLR provisions. CS Energy does not underestimate the challenge of changing the RoLR event definition while ensuring consumer protections during voluntary and involuntary retailer exits are maintained.

CS Energy also notes the list of “usual retailer behaviour” in the Review that warrant further exploration includes behaviours which should not be considered unusual and behaviours by participants that are not retailers.

With respect to the former, of primary concern is the reference to *“electricity retailers not appropriately hedging customer load thereby being exposed to large changes in wholesale prices”*.<sup>4</sup> Retailers should be free to determine their risk appetite and implement appropriate risk management strategies. The inclusion of retailer hedging on the list of unusual behaviours continues the worrying trend of market bodies interfering with retailers’ risk management decisions (e.g., the risk management interference inherent in the Retailer Reliability Obligation). Market bodies should restrict their focus to deficiencies in the market design and rules rather than the commercial decisions of market participants.

With respect to the latter, CS Energy has concerns with the inclusion of *“significant and potentially speculative contract market activity by physical market participants”*.<sup>5</sup> CS Energy questions why “potentially speculative” behaviour of physical market participants has been included in review of retailer behaviour during volatile market conditions. CS Energy requests clarification from the AEMC of the linkage between physical participants’ contracting decisions and behaviour, and the usual retailer behaviour detailed in the Review. Failing that, CS Energy requests this issue be withdrawn from further examination in this review.

If you would like to discuss this submission, please contact Evan Jones (Market Regulatory Manager) on 0419 667 908 or [ejones@csenergy.com.au](mailto:ejones@csenergy.com.au).

Yours sincerely



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Head of Policy and Regulation

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<sup>4</sup> AEMC, [Review into the Arrangements for Failed Retailers' Electricity and Gas Contracts](#), page 43

<sup>5</sup> AEMC, [Review into the Arrangements for Failed Retailers' Electricity and Gas Contracts](#), page 43