INFORMATION

Electricity market financial resilience

Options paper released for stakeholder comments

The AEMC has published an options paper exploring ways to mitigate the financial risks that could arise following the financial distress or failure of a large electricity retailer.

The options paper is part of the development of our advice to the Standing Council on Energy and Resources (SCER) on whether the financial relationships and markets underpinning the National Electricity Market (NEM) are sufficiently robust to manage the financial consequences of unexpected events.

The paper sets out a range of potential options and explains their advantages and disadvantages, while acknowledging that there is no simple solution to managing the risks caused by a large retailer failure.

We invite stakeholder comments on the options and other issues discussed in the paper. Submissions close on 20 December 2012. We will consider submissions before making any recommendations in an interim report in early 2013.

Current arrangements to manage the failure of an electricity retailer

The NEM currently has arrangements in place to manage the financial distress of a retailer, including retailer of last resort (ROLR) regimes. ROLR arrangements are designed to quickly transfer customers to a new supplier so that consumers continue to receive electricity without disruption if their retailer fails.

The existing market mechanisms have managed the failures of small retailers without causing significant financial issues. However, it is possible that the financial distress of a large retailer could spread financial contagion to other energy market participants. This risk could be exacerbated by the operation of the current ROLR regimes due to the potentially very large liabilities that are placed on the retailer that becomes the ROLR. Almost all submitters to the issues paper that we published in June 2012 shared these concerns.

Why have we developed these options?

The options paper is primarily concerned with the flow-on effects to energy businesses and consumers that arise from the financial distress of a large retailer. The failure of a large retailer could be caused by a wide range of factors, and if it did occur the potential consequences for market participants and consumers could be severe.

Generators, retailers and other businesses in the NEM have complex financial relationships with each other. These relationships primarily arise from the financial contracts (known as derivatives) they use to hedge their exposure to the highly volatile wholesale spot price for electricity. Those contracts and other financial relationships create a high degree of financial interdependency between NEM participants, meaning that if one participant encounters financial difficulties, other participants could also be affected.

Recent events in overseas markets, particularly during the global financial crisis, demonstrated the potential for the financial difficulties of one business to be transmitted to other businesses and cause financial contagion that impacts on the overall efficiency of the market and the long term interests of consumers.

This project is not about perceived risks associated with any individual energy market participants.

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The options paper explores potential options for mitigating risks related to the failure of a large retailer

Submissions on are invited by 20 December 2012

Overview of the options

The options paper discusses a number of potential options that are designed to mitigate the financial risks that could arise following the financial distress of a large electricity retailer and an associated retailer of last resort event.

The failure of a large retailer, as with the failure of any business, will create risks for other people. The options are designed to explore potentially more efficient ways of allocating and sharing those risks between NEM participants, governments and consumers.

The paper poses questions for submitters to consider regarding who is best placed to bear and manage those risks, and whether it is possible to reduce the overall level of risk by sharing risks differently to how they are currently allocated in the NEM.

The options include:

- Options that involve amendments to the ROLR regimes with the objective of improving their ability to manage a large retailer failure, such as revised cost recovery arrangements, enhanced contingency planning requirements and delayed triggering of the ROLR provisions.
- Options that seek to address risks related to the credit support (eg bank guarantees) that the retailer that is appointed as the ROLR would be required to provide to the Australian Energy Market Operator (AEMO) and network businesses following the failure of a large retailer.
- Options that seek to address risks related to the increased costs and liquidity challenges that the retailer that is appointed as the ROLR is likely to face in the period immediately following the failure of a large retailer.
- Options for a last resort government response.

The options discussed in the paper have potential implications for generators, retailers, network businesses, electricity consumers and governments. They do not have significant implications for the broader business community.

Development of the options

The options paper was developed with input and assistance from an industry working group comprising representatives from six of the largest retailers and generators in the NEM. An advisory committee also provided input.

Our development of the options was also informed by a review of overseas approaches to managing the failure of electricity retailers. Those approaches are summarised in an appendix to the options paper.

Next steps

The options paper does not contain recommendations as to which, if any, of the options should be implemented. Stakeholder submissions will be a critical input to our development of recommendations.

The options paper will be followed by an interim report in early 2013. That report will set out our draft advice to SCER on the risks associated with the financial distress of a large retailer and any recommendations for new mechanisms to mitigate those risks in the long term interests of consumers.

Submissions close on 20 December 2012.

We have also published an overview report, which provides a summary of the key issues discussed in the options paper.

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