INFORMATION

Electricity market financial resilience

First interim report released for stakeholder comment

The AEMC has published draft recommendations for measures to reduce risks that might arise following the financial distress or failure of a large electricity retailer.

In June 2012 the Standing Council on Energy and Resources (SCER) formally asked us to provide advice on any risks to the efficient functioning of the National Electricity Market (NEM) arising from financial interdependencies between market participants. The first interim report is part of the development of this advice.

A second interim report will be published in the second half of 2013, focussing on potential sources of financial contagion in the NEM other than the financial distress of a large retailer and ROLR event. A specific issue that we will consider is the G20 reforms of regulation of over-the-counter derivatives.

We expect to provide our final recommendations by the end of 2013.

We invite submissions on the draft recommendations and other issues in the first interim report. Submissions close on 12 July 2013.

Current arrangements to manage the failure of an electricity retailer

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

The existing arrangements have managed the financial failure of small retailers without causing significant issues for customers or other market participants. However, if a large retailer experienced financial distress or failure this could have flow-on effects to other energy market participants. This risk could be exacerbated by the operation of the ROLR regime due to the potentially very large financial obligations that would be placed on the retailer that becomes the ROLR. The risk of this occurring is considered small, but the consequences for market participants and consumers if it did occur could be significant. Almost all submitters to our issues and options papers published in 2012 shared these concerns.

Consultation progress

The Commission has benefited from the advice and input of an industry working group and an advisory committee, and the extensive feedback it has received to date following publication of an issues paper in June 2012 and an options paper in November 2012.

The Commission has developed its draft recommendations in light of this input and submissions to the issues and options papers.

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The first interim report sets out draft recommendations for mitigating the risks related to the failure of a large retailer.

Submissions are due by 12 July 2013.

Why have we developed these draft recommendations?

SCER has asked us to provide advice on:

- risks to financial stability in the NEM arising from financial interdependencies between market participants;
- whether the existing mechanisms to mitigate these risks are adequate; and
- if necessary, options to strengthen, enhance or supplement existing mechanisms.

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. Financial contagion refers to the potential for the financial problems of one business to be transmitted to other businesses, to the detriment of the long term interests of customers.

Based on our analysis and submissions to our earlier papers we consider that, although unlikely, the key risks of financial contagion in the NEM could arise in the event of a large retailer failure and an associated ROLR event.

The first interim report considers prudent measures to mitigate these risks. Our second interim report will consider other potential sources of financial contagion in the NEM

Overview of the draft recommendations

Our draft recommendations incorporate two elements:

- Changes to the ROLR scheme and the credit support arrangements required by the Australian Energy Market Operator (AEMO). These changes aim to mitigate the risk that an otherwise solvent retailer is unable to fulfil the significant financial obligations imposed on it due to its appointment as the ROLR.
- Further development and assessment of a special administration regime which could be used instead of the ROLR scheme in some cases. It could be triggered if one of the largest retailers encountered financial distress and there was concern that the ROLR scheme would not effectively manage the orderly transfer of customers without the risk of financial contagion in the NEM.

The proposed changes to the ROLR scheme and AEMO credit support arrangements may mitigate some but not all of the risks of financial contagion arising from a large retailer failure and ROLR event. As a result we see merit in developing a special administration regime as a complement to the ROLR regime. This regime provides a predictable framework for managing the consequences of a large retailer failure, avoiding the need for unplanned government intervention that could otherwise be required if a risk of contagion arose.

Our draft recommendation is that further work should be undertaken to develop the detailed design of a special administration regime.

Next steps

Submissions to the first interim report close on 12 July 2013.

We will develop our final recommendations and advice to SCER after consideration of stakeholder views in relation to both interim reports. We expect to publish our final report by the end of 2013.

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4 June 2013