To suspend or not to suspend-that is the question

Response to National Electricity Amendment (Market Participant Suspension Framework) Rule 2016

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The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade and Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumers' Advocacy Program

This Program was established at PIAC as the Utilities Consumer's Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Tenants Union of NSW;
- Ethnic Communities Council of NSW;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW; and
- Good Shepherd Microfinance.

Introduction

PIAC welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Consultation Paper on the National Electricity Amendment (Market Participant Suspension Framework) Rule 2016'.[1]

The proposed rule change seeks to clarify the arrangements for the suspension of a market participant and the triggers that lead to the suspension of a market participant. Specifically, it aims amend the National Energy Rules (NER) to:

- Remove ambiguity relating to the Australian Energy Market Operator's (AEMO) discretionary power to suspend a market participant when it is under external administration
- Require AEMO to consider a range of factors when deciding whether to suspend a market participant that is under external administration
- Clarify AEMO's ability to suspend a market participant's registration if they have multiple registrations i.e. generation and retail
- Require AEMO to notify the relevant market participant and the Australian Energy Regulator (AER) of any decision against suspending the market participant, as well as and the conditions imposed on the participant as part of that decision.[2]

For the purposes of this rule change, market participants are:

- Market generators;
- Market small generation aggregators;
- Market customers;
- Market network service providers, both transmission and distribution.[3]

Current market suspension procedures and triggers

Under current procedures, a default event triggers the issuing of a default notice, which outlines the default event and the measures required to rectify it. If the market participant does not address the issue, AEMO issues a suspension notice. This suspends the market participant and disallows them from trading in the electricity spot market. There are three types of default event:

- The market participant fails to make a payment to AEMO when requested;
- There is a problem with the credit support of a market participant; or
- An insolvency process is initiated against the market participant.[4]

If a market participant is in financial distress, there is a risk that this will create knock-on effects in the rest of the market, potentially triggering a wider financial collapse of other market participants or a financial contagion event, which is where a shock or sudden event causes financial distress. This is because the National Electricity Market (NEM) is a gross pool market, where the aggregate money paid into the market must match the aggregate amount paid out of it. If one participant is unable to meet its commitments, there may be risks created in the rest of the

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1 AEMC Consultation Paper. *National Electricity Amendment (market participant suspension framework) rule 2016*. June 2016.
2 Ibid 5-6.
3 Ibid 3.
4 Ibid 2.

market.[5] It is not uncommon for payments to remain outstanding, as settlement usually occurs five weeks after electricity is used.[6]

The rule change is the result of the 2015 NEM Financial Market Resilience Report, which identified current issues in the suspension framework regarding market participants who are placed under external administration.[7] The review and subsequent rule change proposes to provide AEMO with greater discretion when making a suspension decision. This is primarily because under some forms of external administration, the market participant may continue to operate on a business as usual basis and therefore may not be a significant risk to the market. In fact, there may be benefits in allowing them to continue to participate. This is particularly the case with generators; they are considered to have lower risk of spreading financial risks in the market, given that they are largely net receivers of money.[8] In comparison, retailers could face greater losses than those faced by generators in the event of a market failure (such as an Over the Counter (OTC) derivative failure), making retailers a greater risk of causing financial contagion.[9]

The type of external administration that a market participant is placed under may influence AEMO's decision making. Voluntary or involuntary administration may require different responses. If the external administrator decides to allow the market participant to continue operating, then it may be less appropriate to suspend the entity. However, if the external administrator determines that the best course of action would be to cease operation, and then the participant should be suspended from the market.

Appropriate assessment framework

The rule change proposes to assess the changes against the following principles:

- Financial stability;
- Reliability and system security; and
- Regulatory certainty and flexibility.

Given the nature of the issue it may be appropriate to give greater weight to financial stability over the other two principles, depending on the type of market participant. PIAC further discusses this in the 'Reliability and financial stability' section below. PIAC believes that system security and reliability are important factors that should also be considered in any decision to suspend a market participant as these may affect the supply of electricity and the security of the system.

Recommendation 1

PIAC supports the AEMC's proposed assessment framework to guide AEMO's decision making on whether to suspend a market participant.

Risks of external administration

The AEMC is seeking feedback on the types of risks caused by allowing a market participant to continue operating under external administration. The Commission has identified that one risk would be the continued accumulation of debt when a non-suspended market participant

5 Ibid 2.
6 Ibid 3.
7 AEMC *NEM financial market resilience, Final Report*, March 2015.
8 Ibid 4.
9 AEMC see above no 1 24.

continues to buy electricity in the spot market. Another risk that may be considered in AEMO's decision making is that any financial contagion may be exacerbated by the immediate removal of a participant from the market.[10] These risks demonstrate the fine balance required in decision making to keep the system stable.

Another risk factor to consider is the potential for a suspended retailer to trigger a retailer of last resort (ROLR) event and possibly spread financial contagion in that way. This may leave the ROLR with an increased customer base and therefore requiring increased credit support.[11] The risk would be greater if a large retailer is suspended. Consideration should also be given to whether the retailer under external administration is the registered ROLR, as this would have further implications for the transfer of impacted customers.

According to the Financial Market Resilience Report there are a number of risks associated with suspending or not suspending a generator. The suspension of a generator could lead to higher spot prices, which would have knock on effects for retailers and other market participants. In addition, the suspension of a generator may lead to an OTC default event, which could lead to financial risks spreading within the market.[12]

The benefits appear to outweigh the risks of allowing a generator, rather than a retailer, to continue to operate in the market while under external administration. PIAC would be concerned about the potential risks to consumers in allowing a retailer under external administration to continue to participate in the market. To reduce these risks, it may be appropriate for AEMO to make a claim for any credit support the retailer has held under the specific arrangements provided in clause 3.15.21(b) (2).[13]

Under the rules of external administration, the appointed administrator could be liable for any debt incurred during trading. They may therefore prefer to cease operating in the market. In this regard, PIAC considers that measures should be taken to ensure that the market is protected from exposure to further risks if the market participant is not suspended and the administrators do not wish to administer the entity.

Recommendation 2

PIAC recommends that, in some circumstances, generators should be allowed to remain a market participant while under external administration.

Recommendation 3

PIAC recommends that if AEMO does not suspend a retailer, it should assess whether it is appropriate and financially prudent to draw on any credit support paid by the retailer.

Selective suspension

There may be occasions where a business entity has multiple registrations in the NEM as market participants. The most common example is a vertically integrated generator and retail business. The rule change seeks to determine whether AEMO should be able to suspend one registration

10 Ibid 12.
11 Ibid 4.
12 AMEC see above n7 67.
13 See Cl. 3.15.21(b)(2) of the NER.

but not any other registrations linked to the business.[14] Presumably these entities are ring-fenced, which should prevent risks from spreading between the suspended and non-suspended participants.

PIAC is of the view that as long as there is no conflict between the type of external administration and the decision making of the appointed administrator, it is appropriate to allow one arm of the company to remain in the market, while suspending the other arm. The benefits of this approach should outweigh any additional complexity associated with selective suspension. This would depend on how the different market participants are structurally and financially arranged, and which registration or part of the company is under external administration.

Recommendation 4

PIAC supports AEMO being given the discretion to selectively suspend a business' registrations in the NEM, as long as the various market participants of the business are ring-fenced and the added complexity of this process does not outweigh the benefits.

Reliability and financial stability

As previously stated, PIAC supports the consideration of system reliability and security as part of AEMO's decision-making process. This is especially important when deciding whether to allow a generator to continue operating under external administration. In this case, PIAC believes that system stability should be given equal weighting to financial stability as the suspension of a large generator may put pressure on the system with other generators forced to increase production to meet demand. Additionally, the size of the generation asset should be factored into the decision. Allowing different generation capacities and registrations – such as scheduled (over 30MW), non-scheduled (under 30MW) and semi-scheduled (intermittent generation with capacity over 30MW, such as wind or solar) – to continue to operate in the market will impact on the market in different ways.[15]

Where the decision relates to a retailer, PIAC contends that system stability should be considered but given a lower weighting than financial stability. This is due to the different roles and risks that generators and retailers contribute to the market.

Recommendation 5

PIAC recommends that AEMO should consider reliability and system security when deciding whether to suspend a market participant. The weighting of these factors should be different for generators and retailers.

AEMO discretion

The commission has sought feedback on a number of questions about the limits of AEMO's discretion in deciding whether to suspend a market participant. PIAC is of the view that AEMO should consider the range of factors suggested in the rule change and that its reasoning should made be publically available. This will provide market participants with the information needed to make financial decisions. These factors shouldn't limit AEMO's discretion, as depending on the case, additional issues may need to be considered. In this case, these should be published along with AEMO's decision. AEMO should be able to impose conditions on a non-suspended market

14 AEMC see above no 1 13.
15 Ibid 14.

participant to ensure that there is monitoring of their market position and that the suspension can be reviewed.

Any decision to not suspend a market participant should be reviewed periodically or if new information is received. If external administration is voluntary with the aim to keep the business running, then the exemption from suspension should be reviewed in line with timeframes given for voluntary administration under the *Corporations Act 2001*. If the company improves its financial position then the exemption should be reviewed and lifted. If the decision is made to liquidate the company, then the company should be suspended from the market.

Where possible, AEMO should consult with the AER in its decision making process, particularly if the market participant is a retailer. This is because the AER has responsibility for administering the ROLR process. PIAC recognises that there may be occasions where a swift decision is needed, leaving little time to consult the AER. In this instance, AEMO should make a short-term assessment and then consult with the AER and other relevant parties before implementing a longer-term decision.[16]

If AEMO is given greater discretion to not suspend a market participant under the rules, then there may be benefit in broadening what is considered a default event. Default events for non-market participants who are registered in the NER are listed in clause 3.15.21, and include situations where a credit provider is unable to continue to provide credit support to a market participant.[17] Considering that the global financial crisis was a driving factor in the Financial Market Resilience Review, this may be relevant as credit market changes may continue to impact the energy sector.[18] In order to mitigate the risk of creating more default events than AEMO can handle, it may be appropriate to develop sub-categories of what would constitute a default event. That is, if a market participant is not suspended in the market but one of the sub-categories occurs, then a review of the market participant's registration would be triggered.

Recommendation 6

PIAC recommends that, AEMO consider a range of factors in making a decision. These factors should be published when they are developed.

Recommendation 7

PIAC recommends that AEMO consult with AER when making a decision about whether to suspend a retailer, as the AER is responsible for administering the ROLR process.

Recommendation 8

PIAC recommends that if greater discretion is given to AEMO when making a decision, it should consider a range of other market failures that may lead to financial risks spreading in the market, beyond those listed as default events in the NER.

Recommendation 9

PIAC recommends that AEMO review non-suspension decisions periodically or where new information arises that could lead to a revocation of a non-suspension decision.

16 Ibid 17.
17 See Cl. 3.15.21 of the NER.
18 AEMC see above n 7 ii.

Compliance and the AER's role

The Financial Market Resilience Review indicated there is a risk that the AER may not be able to enforce infringement notices on market participants operating under external administration.[19] PIAC is particularly concerned about the prospect of limited enforcement capabilities and the impact this may have on vulnerable consumers. The AER issues infringement notices to retailers that fail to comply with the National Energy Consumer Framework (NECF), such as where a retailer disconnects a consumer who is on life support. If a retailer under external administration is allowed to continue to operate in the market, then procedures need to be in place to ensure that the AER is able to effectively enforce the NECF.

Currently the AER is responsible for managing the Retailer of Last Resort (ROLR) process, which involves transferring customers of a suspended or failed retailer to the registered ROLR. Under the current ROLR guidelines, the AER must run test ROLR exercises every 12-18 months or when needed.[20] If the rule change provides AEMO scope to allow a retailer to remain a market participant while under external administration, the AER should assess and amend the ROLR procedures where necessary, and run a test exercise as soon as practical. In doing so, PIAC suggests that it could factor in existing notification requirements to ensure that there are adequate procedures for dealing with a retailer that may be at risk of suspension in the immediate future.

Recommendation 10

PIAC recommends that the AER should be able to continue to issue and enforce infringement notices where a retailer is allowed to remain a participant while under external administration.

Recommendation 11

PIAC supports AEMO having the discretion to make a decision before consulting with the AER if an immediate decision is required. They should endeavour to consult with AER as soon as possible before deciding on a longer-term decision.

Recommendation 12

PIAC recommends that the AER review and, where necessary, amend the ROLR procedures and conduct a test ROLR exercise after the rule change.

Conclusion

The NEM market is a balanced system and there are events that will require the suspension of market participants to prevent the spread of financial risks. However, there may be occasions where it is better to allow a participant to continue operating in the market as the risks of suspending them are greater than the risks of allowing them to continue to operate. PIAC is supportive of providing AEMO with greater discretion in making decisions to not suspend a market participant, as long as the non-suspended party is required to adhere to the NECF and its customer protections.

[19] Ibid 146.
[20] AER, Retailer of Last Resort plan. July 2015, 20.