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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South 1235

Submitted Electronically via www.aemc.gov.au

Dear Mr Pierce

National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 & National Gas Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.5 million household and business customers in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia, including coal, gas and wind assets with control of over 4,500MW of generation in the National Electricity Market.

EnergyAustralia welcomes the opportunity to provide input in the AEMC's consultation on retailer-distributor credit support arrangements under the National Electricity Rules and National Gas Rules. We believe that this conversation cannot be had in isolation from the COAG Energy Council proposal of retail insolvency pass through and we welcome the AEMC's approach to consolidating these proposals.

As previously submitted[1], the issue of the appropriate allocation of risk is at the heart of the credit support proposal and we believe that the market has evolved in such a way that the credit support settings implemented at the commencement of the National Electricity Rules (NER) and National Gas Rules (NGR) may no longer represent the most efficient solution.

We believe that the Credit Support arrangements should adequately reflect the risk to distributors of retailer default but should also be mindful of the context in which other elements of the supply chain operate. For example, while distributors face the risk that a retailer will become insolvent, it is in fact the retailer who faces considerable credit risk given

[1] EnergyAustralia submission in response to Rule Change proposal ERC0183, Retailer-Distributor Credit Support Requirements

the range of regulatory constraints and reputational damage associated with collections and disconnections activity. It is crucial that this crucial that any credit support arrangement does not lead to the perverse outcome of increasing this risk by increasing the cost burden on the retailer, which under the current settings is already considered to be at an elevated risk of default.

Given these views, we believe that maintaining the current credit support provisions would prolong the inefficient allocation of resources, the cross subsidization which currently occurs from large to small retailers, and lead to suboptimal outcomes for consumers who will ultimately bare the cost of these inefficiencies.

We believe that the risks faced by distributors do not warrant the imposition of onerous credit support arrangements on larger retailers. While it is true that distributors face a degree of liquidity, revenue and cost risk, EnergyAustralia considers that the current credit support arrangements overstate these risks and inappropriately allocate a considerable portion of this risk to the retailer. This is particularly inappropriate considering the distributors' ability to recover unrealized revenue in subsequent regulatory periods. Further, any Retailer of Last Resort (ROLR) event will lead to operational costs to the distributor which will presumably have a fixed component. These fixed costs will therefore be larger relative to the overall amount of credit support payable by a smaller retailer and it seems does not seem reasonable that the current framework does not reflect this in some way.

Preferred Option

EnergyAustralia is concerned that within the option to "strengthen the framework" there is no real discussion of what is meant by strengthening. This term is quite subjective due to the differing incentives and risk profiles of the stakeholders involved. We take this concept to mean an improvement in the overall integrity of the framework in relation to the principles outlined in the Options Paper. As such, the AGL proposal is our preferred option on the basis that it achieves this outcome.

By removing the concept of a maximum credit allowance as a proportion of a distributor's total annual retail charges, the AGL proposal allows for the direct evaluation of the real risk faced by the distributor. Any credit support regime which more accurately reflects the verifiable value at risk of an individual retailer would be an improvement on the current settings as it would ensure that each retailer's liability accords with the potential losses that would be suffered by the retailer in the event of default.

The AGL proposal also achieves a purer policy outcome in the sense that it is simply a mechanism to ensure that distribution businesses are appropriately insured against the impacts of the failure of a retail business. The existing arrangements, on the other hand, have the additional objective to stimulate competition. However, by placing a greater credit support burden on larger retailers, the current arrangements provide incentives for smaller, potentially riskier retail businesses to enter the market without adequate financial capability. It makes little sense to encourage new market entrants by artificially suppressing prudential requirements. As the Access Economics report states, "*The credit support scheme is (or should be) about protecting DNSPs and customers from retailer defaults. There are two problems with using this scheme to try to encourage new entrant retailers. First, there are more direct and economically efficient methods for encouraging retail competition – the credit support scheme is a blunt instrument for that purpose. Second, if the objective of the credit* *support scheme is to foster retailer competition, it will inevitably be less effective in fulfilling its original purpose – protecting DNSPs and customers from retailer defaults*."[2]

Summary

EnergyAustralia supports the AGL proposal on the basis that it appropriately allocates risk to those parties who are best able to manage it. The current arrangements appear to be somewhat arbitrary in nature and disproportionally impact large retailers. We do not consider these arrangements to be in the long term interests of consumers as they can potentially result into a worsening of distributors' risk profile as stable retailers are burdened with large credit support liabilities while smaller retailers are not provided with a sufficient incentive to curb risky behavior.

Cognisant of the AEMC's ability to make a "more preferable rule" we are concerned that the scope of Option 2 may lead to an outcome which is in fact considerably different to the AGL proposal in its approach to strengthening the existing framework. We urge the AEMC to continue its thorough consultation on this matter to ensure that the best possible outcome is reached.

If you require any further information with regard to this submission, please contact me on 8628 1731 or via email at joe.kremzer@energyaustralia.com.au

Yours sincerely,

Joe Kremzer
Regulatory Manager, Retail

[2] ACCESS Report.