27 November 2015

REF ERC0183

Ms Anne Pearson

Senior Director

Australian Energy Market Commission (AEMC)

Level 6, 201 Elizabeth Street, Sydney NSW 2000

Dear Ms Pearson

This submission is prepared jointly by the following energy retailers:

- Blue NRG Pty Ltd
- Pooled Energy
- People Energy
- M2 Energy
- QEnergy
- Click Energy

We welcome the opportunity to comment on the Australian Energy Market Commission (AEMC) *Options Paper - National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 National Gas Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015* (the 'options paper').

Background

The AEMC's October options paper canvassed several options to manage risk of retailer default and reduce distributor exposure. These are:

- **Option 1**: retain the existing arrangements - the existing arrangements for both the credit support requirements and the cost pass-through provisions would remain as currently set out in the NER and NGR.
- **Option 2**: strengthen the existing arrangements - variations to the current credit support requirements and cost-pass through provisions, including but not limited to, the AGL proposal, the COAG Energy Council proposal and the Jemena proposal (several specific options to strengthen the existing arrangements are considered in the options paper)
- **Option 3**: establishment a retailer default fund which would be available to distributors in the event of a retailer default, and would be funded by retailers based on a set formula prescribed in the NER and NGR.
- **Option 4**: introduce a liquidity support scheme - a liquidity instrument to be held by the distributor to be used to address cash-flow issues arising from a retailer default. Under this option the costs associated with the liquidity support scheme could be paid by the distributor or collected from the retailers based on a set formula prescribed in the NER and NGR.[1]

Our preferred options are option 1. However, if the Commission determines that a change is necessary, then option 2.1 is preferable. Our reasoning for this is set out below.

General considerations

Several retailers prepared a joint submission in July 2015 to the Australian Energy Market Commission's (AEMC) Consultation Paper - National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 and National Gas Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 (the 'consultation paper'). That submission suggested that current arrangements to manage the risk of retailer default were adequate and that, should any change occur, a cost pass through (available in the event of retailer default) would be the most appropriate mechanism to provide additional protection for distributors.

Minimising impact on retail competition

Effective retail competition is recognised by the AEMC as promoting the long term interests of consumers, and we strongly agree with this proposition. We would be concerned with any option which would lessen competition by increasing the barriers to entry for new market entrants and smaller players.

Specifically, options 2.3 and 4.2 seek to allocate costs to retailers against Dun & Bradstreet risk scores and Standard & Poor's ratings. The cost burden that these options place on lower rated retailers or new market entrant retailer would result in a significant competitive disadvantage compared to higher rated retailers.

Minimising cost

Whilst we acknowledge that the risk of retailer default must be appropriately managed, we believe that any risk mitigation mechanisms should be introduced at the lowest possible cost to market

[1] AEMC Options Paper, National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 National Gas Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015, p. ii.

participants, to avoid both barriers to entry and undesirable cost inefficiencies associated with 'over insuring' against the risk of a retailer default. Any such costs would be ultimately borne by energy end users.

In their report, Promontory identified that option 2.1 would impose the lowest ongoing costs to electricity consumers and the equal-lowest ongoing costs to gas consumers. It is appropriate for post-default costs to be significantly higher than ongoing costs, given the low-likelihood of significant retailer failure.

Responses to specific options for a rule to manage the risk of retailer default

Preferred option

We support option one. As noted in our previous submission, it is not evident that any inherent problem exists with the current credit support regime, and we believe that the credit risks to which a distributor is exposed can be managed through the current rule structure. The existing structure appropriately balances both the likelihood and the impact of potential retailer insolvency loss to distributors.

We also consider that this option would carry the lowest cost impact and avoid any detrimental impacts to market competition.

Notwithstanding this, should the AEMC determine that changes to the existing regime are necessary; our view is that option 2.1 is the most appropriate option to address risks of retailer default.

Second preferred option

Our preferred alternative is option 2.1, being a cost pass through option as proposed by COAG / Jemena. We believe that this option best balances the long term interests of consumers whilst minimising or avoiding the up-front costs to market participants which would be incurred under options 3 and 4.

Option 2.1 seeks to allocate costs only when and if a default event occurs. Retailer insolvency or non-payment carries the potential for a high magnitude consequence for the distributor (particularly where the retailer is large), but has a relatively low likelihood of occurrence. As noted in our initial submission, a cost pass through option would allow a full recovery of associated costs only when and if they occur, ensuring that retailers, and ultimately end users are not paying for costs not incurred.

As noted above, Promontory's modelling shows that Option 2.1 would imposes the lowest ongoing costs to electricity consumers and the equal-lowest ongoing costs to gas consumers.

Option 2.1 would also avoid difficulties associated with quantifying costs of non-payment or insolvency in advance. A cost pass through would allow costs to be absorbed across a larger group of customers (who ultimately benefit from increased market competition). A potential method to maximise the efficiency of the cost pass through mechanism is to permit a cost pass through only where the distributor has been unable to recover costs through other mechanisms (for example, through corporate insolvency processes).

Options 3 and 4 not preferred

We consider that options 3 and 4 are not desirable, given that they potentially present cost impacts to the market which can be avoided through the use of other risk mitigation mechanisms which provide equal protection to distributors. Additional costs may be ultimately borne by energy consumers, and are also likely to have a detrimental impact on long term market competition by establishing further barriers to entry for new market participants.

Summary

We consider that the risk of retailer default is a risk that is already addressed by the existing regulatory framework. On this basis, we support option 1 in the AEMC's options paper. To the extent that regulatory change is required to better manage that risk, we consider that option 2.1 presented in the options paper better balances the risk of retailer failure and the broader market objectives of increasing market competition than options 3 or 4 suggested in the options paper, and AGL's initial rule change proposal.

We look forward to engaging in further discussions with the AEMC on this issue and providing further comment in this area. Should you have any questions about this submission, please contact Naomi Feast on 03 8888 3305 or via email (naomi.feast@bluenrg.com.au)

Yours sincerely

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