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2 July 2015

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

ERC0183 - NATIONAL ELECTRICITY AMENDMENT (RETAILER – DISTRIBUTOR CREDIT SUPPORT REQUIREMENTS) RULE 2015 – CONSULTATION PAPER.

Ergon Energy Corporation Limited (Ergon Energy) in its capacity as a Distribution Network Service Provider (DNSP) in Queensland welcomes the opportunity to provide comment to the Australian Energy Market Commission (AEMC) on its National Electricity Amendment (Retailer – Distributor Credit Support Requirements) Rule 2015.

Ergon Energy does not support the rule change as proposed as it creates an unacceptable risk profile for DNSPs in that retailers rated BBB-, BBB or BBB+ would no longer be required to provide credit support. However, improving the credit support provisions is warranted as in May this year alone Ergon Energy had 21 external retailers with monthly network charges liabilities ranging from approximately $5,000 to $8.1 million. These are liabilities that Ergon Energy and in-turn our customers are fully exposed to as under the existing rules we are unable to request credit support.

Ergon Energy therefore recommends the AEMC improve the credit support provisions to better balance the risk between likely retailer default and DNSP exposure to any individual retailer. Further, Ergon Energy also strongly supports the Commonwealth of Australian Government's proposal to enable full cost recovery in the event of a default event by removing the materiality threshold.

Should you require additional information or wish to discuss any aspect of this submission, please do not hesitate to contact either myself on (07) 3851 6416 or Trudy Fraser on (07) 3851 6787.

Yours sincerely

Jenny Doyle
Group Manager Regulatory Affairs

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Enc: Ergon Energy's submission

# Submission on the *National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015*

2 July 2015

# Submission on the *National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015*

## Ergon Energy

## 2 July 2015

This submission, which is available for publication, is made by:


Ergon Energy Corporation Limited

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# Introduction

Ergon Energy Corporation Limited (Ergon Energy) in its capacity as a Distribution Network Service Provider (DNSP) in Queensland welcomes the opportunity to provide comment to the Australian Energy Market Commission (AEMC) on its Consultation Paper - *National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015* (Consultation Paper).

Ergon Energy notes that under the current rule there is minimal credit support provided to DNSPs and inadequate means for distributors to effectively manage or mitigate the risk of retailer default.

In May this year alone, Ergon Energy had 21 external retailers with monthly network charges liabilities ranging from approximately $5,000 to $8.1 million. As these monthly liabilities do not exceed any retailer's credit allowance Ergon Energy is unable to request credit support from these retailers. This means Ergon Energy, and in turn our customers, continuously carry significant exposure to retailer default. As such we support updating the credit support provisions to enable Ergon Energy to request credit support from retailers to mitigate the crucial cash flow impacts and costs associated with a retailer default.

Credit support arrangements between distributors and retailers support the integrity of the electricity market in a similar way to the prudential arrangements that the Australian Energy Market Operator manages between generators and retailers. To be effective, the credit support arrangements (i.e. bank guarantees) between distributors and retailers should be capable of being enforced by distributors in a timely manner.

AGL's proposal would result in a significant shifting of risk from retailers to the distribution business wherein retailers rated BBB-, BBB or BBB+ would no longer be required to provide credit support. This is a perverse outcome for DNSPs. As noted by the AEMC in the Consultation Paper "the main commercial risk faced by distributors is the failure of a retailer to pay its network charges". Any business should be able to adopt measures that protect itself from its "main commercial risk", and not have this risk transferred back onto it as this rule change proposes.

Indeed, and as the AEMC also highlights in the Consultation Paper, risks should be allocated to "the parties that have the information, ability and incentives to best manage each risk in order to minimise the long-term costs to consumers." The distribution businesses do not have the ability to manage the business decisions and debt levels retailers choose to enter into when managing their risk of default. The current credit support guidelines clearly require improving, but not in the manner proposed by AGL. As such, Ergon Energy makes the following recommendations regarding the rule change proposal:

## Recommendation 1

Ergon Energy strongly opposes this rule change proposal. Ergon Energy considers that the credit support provisions in the National Electricity Rules (NER) should take into account both the likely default of an individual retailer (based on their credit rating) and the distributor's level of exposure to an individual retailer. The credit support calculation should be updated to reflect this. To further reduce the distributors' exposure to retailer default; retailers should not be able to unreasonably withhold consent to increase the frequency of network payments to distributors if requested, if it assists to reduce the network charges outstanding liability, and as a result, the mechanism for credit support to be provided.

### *Cost Recovery*

This rule change consultation also incorporates the Commonwealth of Australian Government's (COAG) rule change request to reform the definition of a retailer insolvency event and to class such an event as a positive change event under the NER. COAG's request would remove the materiality threshold that currently prevents distributors from recovering forgone revenue in the event of a default (if the threshold is not reached).

### Recommendation 2

Ergon Energy supports COAG's proposal, as it will enable full cost recovery.

### *Other issues*

In the absence of credit support being provided, if retailers are late in their network payments there is no recourse for the DNSPs to recover any costs incurred in covering these late payments, which would eventually be passed through to customers.

### Recommendation 3

As such Ergon Energy supports a mechanism being developed to enable cost recovery from retailers (not in default) for any expenses incurred by the distribution businesses for the late payment of retailers' network charges.

The reasoning behind these positions is further detailed in response to the AEMC's feedback questions below.

Ergon Energy is a member of the Energy Networks Association (ENA), the peak national body for Australia's energy networks. Ergon Energy is fully supportive of the issues raised in the ENA's submission.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

| Consultation Paper Feedback Question<br><br>Question 1: Current credit support requirements | Ergon Energy Comment |
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| (a) Do distributors request credit support in all circumstances permitted under the current arrangements?<br><br>(b) If not, why not? | The credit support requirements were introduced into the NER as part of the National Energy Customer Framework in 2011. However the NECF has only recently been adopted in Queensland and commenced operation on 1 July 2015. Until that time, Ergon Energy has been subject to the jurisdictional credit support provisions administered by the Queensland Competition Authority.<br><br>Ergon Energy does not request credit support from:<br><br>• Ergon Energy Queensland Pty Ltd (EEQ) as it is a 100% owned subsidiary of Ergon Energy Corporation Limited (EECL) (however if EEQ were to separate from the Group and to operate as a stand-alone retailer, EECL would require credit support to be provided by EEQ); or<br>• External retailers as the monthly network charges liability does not exceed the Retailer's credit allowance triggering the ability to request credit support.<br><br>The network charges paid by EEQ to EECL accounted for approximately 81% (equivalent to $1.7 billion) of EECL's total forecasted network charges revenue in the 2014-15 financial year.<br><br>Of the external retailers, approximately 21 of the 30 listed retailers on EECL's books were active at the end of May 2015 and had monthly network charges liabilities ranging from approximately $5,000 to $8.1 million (equivalent to approximately $400 million annually in FY2014/15). |
| (c) What issues have been identified by distributors and/or retailers in the implementation of the current credit support requirements? | Unless the retailer makes the payment via real time gross settlement (RTGS) it is not possible to determine if the network charge has been received until the following business day.<br><br>The distributor must provide at least three business days' notice in advance of calling on the credit support. If EECL as a distributor were to have a cash flow problem from the non- |

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| | receipt of the network payment this would have already occurred on the due date and potentially caused the bank balance to become overdrawn. Arrangements to borrow the shortfall in funds would have to be made on the day; with interest costs accruing until the due network charges are received. There is no recourse for a distributor to recover the additional interest costs caused by the retailer default of payment.<br><br>Other mechanisms such as having large customers with remote readable meters pay more frequently such as weekly or fortnightly would be more effective. |
| **Question 2: Identification of Appropriate Principles** | |
| (a) Are these principles appropriate for designing a rule for managing the risk of retailer default? | It is appropriate that those retailers with a higher risk profile are required to provide additional credit support or agree to an alternative mechanism.<br><br>Accordingly, it will result in a significant cost and time saving to those retailers with a lower risk profile. |
| (b) Are there other factors market participants would expect to be considered in an effective rule for managing the risk of retailer default? | No comment. |
| **Question 3: Risks and impacts related to retailer default** | |
| Have all of the risks faced by distributors related to retailer default been outlined above? If not, what other risks do parties face in relation to network charges due to the risk of retailer default? | No comment. |

| Question 4: Management of risk to reduce costs | |
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| (a) Do the costs imposed on retailers by the current rules (or potentially by the proposed rules) lead retailers to take actions to better manage their risks in order to reduce their costs? | No. EECL (as a distributor) does not request credit support from EEQ (Ergon Energy's retail business) under the current ownership arrangements. EEQ also would not agree to a request from EECL to pay their bill in advance or to pay their bill more frequently so as to reduce the amount of credit outstanding in any month unless they were obligated to do so. |
| (b) Do the costs imposed on gas retailers under their access arrangements (or potentially by the proposed rules) lead retailers to take actions to better manage their risks in order to reduce their costs? | Not applicable. |
| (c) Do the risks borne by electricity distributors under the current rules (or potentially by the proposed rules) lead distributors to take actions to better manage the risk of retailer default? | Ergon Energy notes that distributors have limited ability to manage the risk of retailer default. |
| (c) Do the risks borne by gas distributors under their access arrangements (or potentially by the proposed rules) lead distributors to take actions to better manage the risk of retailer default? | No comment. |
| (d) Do the costs imposed on consumers by the current rules (or potentially by the proposed rules) lead consumers to make informed decisions about purchasing electricity or gas from their retailer? | Ergon Energy considers it very unlikely that consumers are even aware of, let alone considering the costs incurred by these rules when making their purchasing decisions. |

| Question 5: Reducing risk of non-payment | |
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| (a) What operational decisions could retailers make to reduce the risk of their own default on payments to distributors? | Retailers could agree to pay the network charges to distributors at a higher frequency than monthly and therefore reduce the level of the outstanding payment and reduce the size of the risk.<br><br>Retailers could also undertake activities to strengthen their credit rating and thereby reduce the credit support requirements and the risk of default. |
| (b) Would retailers undertake these operational decisions if the rule to manage the risk of retailer default did not impose a credit support requirement? | In the absence of a mandatory credit support requirement, Ergon Energy considers it unlikely that retailers would undertake operational decisions such as those suggested above. |
| **Question 6: Purpose of Rule** | |
| (a) Is this the correct approach to consider the level of protection to be provided by a rule to manage the risk of retailer non-payment? | Ergon Energy considers that the credit support should take into account both the likely default of an individual retailer (based on their credit rating) and the distributor's level of exposure to an individual retailer. The credit support calculation should be updated to reflect this. |
| (b) Are there any other protections provided by a rule to manage the risk of retailer non-payment? | No comment. |
| **Question 7: Changes in the calculated amount of credit support required** | |
| (a) How often do retailer-distributor credit support requirements currently change? | As noted earlier in this submission, Ergon Energy does not currently require credit support to be provided by any of the retailers with which it has commercial dealings. As also noted earlier in this submission, the NER provisions that were implemented under NECF will only |

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| | come into force in Queensland on 1 July 2015. As such Ergon Energy has had no previous exposure to changing credit support requirements. |
| (b) What would be market participants' preferred frequency of changes to the required level of credit support provided by retailers to distributors? | Ergon Energy considers that this should be aligned to the movement in the retailer’s credit rating (at least annually, but not more frequently). |
| (c) How do frequent changes in credit support requirements affect retailers? | Frequent changes in credit support arrangements would require retailers to invest substantial time and resources to an activity, with minimal long-term benefit. Consistent with our response to the above question, Ergon Energy considers that changes to the credit support arrangements should be undertaken at least annually, but not more frequently. |
| (d) How could other approaches to a rule for managing the risk of retailer default improve regulatory certainty or flexibility? | No comment. |
| **Question 8: Barriers to Entry** | |
| (a) Are credit support requirements a barrier to entry or expansion for small retailers? | For most unrated retailers or those with a rating below BBB-, banks will require a cash deposit for the full face value of the bank guarantee before issuing a bank guarantee. This imposes a significant cost on these retailers and ties up large amounts of capital. That said, new entrants into the market or those seeking to expand should be able to access the capital required to break ground without exposing customers to unsuitable levels of risk. |
| (b) What control do small retailers have over their credit support costs when entering the market? | To assist in meeting their credit support obligations, a parent entity of the small retailer could provide an undertaking to the bank issuing the guarantee. |
| (c) Would other ways of reducing a retailer's liability reduce the barriers to entry or | As noted earlier in this submission, an increase to the frequency of payments from customers to retailers to distributors can assist to reduce the level of outstanding payment |

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| expansion faced by small retailers? | and therefore any associated credit risk. |
| **Question 9: Balance of credit risk and impact risk** | |
| (a) Is AGL's proposal an improvement over the current credit support requirements? | There are certain aspects of the AGL proposal that will result in an improvement to current credit support requirements. However, there are other aspects which Ergon Energy considers would represent an unsatisfactory outcome for DNSPs. This is explained in further detail below. |
| (b) Given your answer to (a), explain why or why not. | While it places the onus of credit support onto those retailers with the higher risk profiles, it also removes the need for other retailers to provide credit support thereby exposing networks to increased risk, outweighing the initial benefit. |
| **Question 10: Recovery through the regulatory determination process** | |
| (a) What are the advantages of the regulatory determination process in terms of recovering revenue related to managing the risks associated with retailer default? | Ergon Energy is subject to a revenue cap arrangement which means it can recover forgone revenue through the adjustment of prices to meet the maximum allowed revenues as determined by the AER. Using insurance and including the costs in the revenue building block allows risk to be spread over time. |
| (b) How does this mechanism compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default? | There is a significant time lag in the recovery of revenues under a revenue cap leaving businesses exposed to cash flow shortages which could become critical. Further, opex funding for insurance policies is subject to the AER Distribution Determination process. There is only one genuinely effective measure to prevent such shortages in the event of retailer default and that is credit support provisions that provide network businesses with efficient access to the necessary funds that we are entitled too. |
| **Question 11: Recovery through the cost** | |

| pass-through mechanism | |
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| (a) What are the advantages of the cost-pass through mechanism in managing the risks associated with retailer default? | This is a clean mechanism which can be relied upon in the event of a retailer default, but one that comes with time delays impacting cash flow. |
| (b) How does this mechanism compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default? | Provided that the materiality threshold is removed this option is one that could be relied upon, but again, comes with critical time delays impacting cash flow. |
| **Question 12: Recovery through the corporate insolvency process** | |
| (a) What role does the corporate insolvency process play in providing a sufficiently effective and transparent means of managing retailer default? | This is a difficult avenue for recourse from the retailer but on face value could lessen the impact on the customer. However, in practical terms there are no guarantees of cost recovery and the legal process is long, protracted and costly. |
| (b) How does this mechanism compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default? | This should only be used as a last resort mechanism. The other two mechanisms are preferable alternatives. |
| **Question 13: Management of risk through the minimisation of network charges liability** | |
| (a) What are the advantages of mechanisms to minimise a retailer's network charges liability in managing the risk of retailer default? | The ability to increase the frequency of small customer's bills is limited given that they do not have remote readable meters and consequently the requirement to conduct more frequent manual meter reads significantly adds to the cost. However, large customers do have remote readable meters and hence the ability to increase the frequency of these bills could be a feasible option. This has the advantage of reducing outstanding debt owed to |

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| | DNSPs. |
| (b) How do these mechanisms compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default? | Other than increasing bill frequency, there are limited other measures available for distributors to manage risks of retailer default. |
| (c) Are there any practical considerations of developing and implementing mechanisms to minimise a retailer's network charges liability? If so, what are these considerations? | It would be unlikely that retailers could pay the network charges in advance given the billing cycle for the receipt of payments from customers is approximately 92 days. Specifically, new provisions introduced under the NECF, requires a retailer to issue a bill to a small customer at least every three months. |
| **Question 14: Relationship between mechanisms to manage the risk of retailer default** | |
| (a) How do the various mechanisms available to manage the risk of retailer default work to complement each other in ensuring that the risk of retailer default is managed in the most efficient manner? | Ergon Energy considers that paying in advance, increasing the frequency of payments and provision of credit support, are complementary mechanisms for managing the risk of retailer default. |
| (b) How should these different mechanisms be combined in a regime to manage the risk of retailer default to ensure an efficient outcome? | Retailers should not be able to unreasonably withhold consent to increase the frequency of network payments to distributors if requested. Particularly if this assists to reduce the network charges liability outstanding, and as a result, the mechanism for credit support to be provided. |