21 December 2016

Mr Alan Rai
Director
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Email: aemc@aemc.gov.au

Dear Mr Rai

Retailer-distributor credit support requirements – Draft Rule Determination

Origin Energy (Origin) welcomes this opportunity to respond to the Australian Energy Market Commission (AEMC) Retailer-Distributor Credit Support Draft Rule Determination.

As set out in the Draft Rule Determination there are a number of mechanisms for distribution businesses to manage financial risks of a retailer defaulting. These being through regulatory revenue determinations (unders and overs), corporate insolvency processes, insurance arrangements and recovery under the retailer insolvency cost-pass through mechanism. The existence of a retailer of last resort scheme also assists in ensuring that networks can commence billing customers and receive revenues as soon as an event occurs.

It is Origin's view that this framework, with the addition of the more preferable Rules, will ensure distributors are adequately covered in the event of a retailer becoming insolvent and provides a solid basis for a robust retailer-distributor credit support framework in the energy industry.

Further comments on the more preferable Rules and the Draft Determination are set out below.

More Preferable Rules

It is noted that the preferable Rules, as proposed in the Draft Rule Determination, will amend the relevant provisions in the National Electricity Rules (NER) and National Gas Rules (NGR) to:

- Enhance the operation of the retailer insolvency cost pass through provisions such that the materiality threshold will be removed and costs will be recovered in relevant network tariffs;
- Remove the requirement for a retailer to provide credit support to a distributor except in the case of a history of late payment of distributors invoices by a retailer; and
- Retain the existing credit support provisions so that they continue to operate as between any distributor and retailer, where that distributor currently holds credit support from that retailer[1].

Origin believes the acceptance of these preferable Rules will provide regulatory certainty to the market, will mean foregone revenue becomes irrelevant as distributors are able to recover accrued costs in full and ensures consumers only pay the costs relevant to a retailer failure.

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[1] AEMC, Retailer-distributor credit support requirements, Draft Rule Determination, October 2015, pii.

Origin supports the removal of credit support arrangements, except in instances of late or missed payments by a retailer. This framework provides notice to the distributor to take operational steps to minimise financial impacts if a retailer was to default and ensures costs will only be incurred by consumers where a retailer default actually occurs. Origin believes the amount of the credit support being equal to the last statement of charges appropriately covers the distributor for potential outstanding liabilities.

However, the AEMC may need to give further consideration as to whether distributors can hold cumulative amounts of credit support from the one retailer. Under the preferable Rule, it appears that credit support could be requested and held multiple times within a 12 month period. The AEMC may consider it appropriate to place an upper threshold on the amount of credit support that can be held at one time by a distributor.

Further, we assume that unamended sections of the Rules will continue to operate as per business as usual. For example, the requirement to provide written notification if a retailer disputes a statement of charges. This written notification is currently satisfied through B2B system notifications in accordance to billing specifications of respective states. This arrangement should remain unchanged.

Origin supports the amended framework becoming effective from February 2017.

Assessment of Risks

As noted in the Draft Determination, a distributor's risk from a retailer default consists of revenue risk, liquidity risk and broader systemic risk.

Revenue risk is eliminated given the preferred Rules remove the materiality threshold from the definitional requirements for a retailer insolvency event and the costs of the event are recovered by networks in relevant tariffs.

In terms of liquidity risk, we agree that distributors are well placed to manage a temporary cash flow shortfall given their strong asset base, existing funding arrangements and the statutory cost recovery mechanisms as set out in the Rules. Origin notes that shortfall funding arrangements did not appear to cause distributor distress when previous ROLR events have occurred in Australia.

Distributors have significant network assets and often have substantial unexpected costs that are not recovered until subsequent regulatory periods. Origin does not view that a retailer default event should be treated any differently to these unexpected events. The AER's final revenue determination for Energex illustrates variances can occur within regulatory periods:

> *"In the determination for the 2010–15 regulatory control period, we included the forecast solar bonus scheme payments in the opex allowance. We included a pass-through mechanism for any difference to be applied two years later during the annual pricing proposal processes. As a result of this mechanism, the expected under-recoveries from 2013–14 and 2014–15 will be recovered in 2015–16 and 2016–17. Based on Energex's revised proposal, these amount to $254.6 million and $222.5 million ($ nominal) respectively. Then, in the 2015–20 regulatory control period, there is no solar bonus scheme forecasts included in the opex allowance. Instead, these amounts will be recovered through a jurisdictional scheme obligation, which will feed into DUoS as part of the annual pricing approval process.*
>
> *Other annual revenue adjustments are also significant. In particular, Energex expects to under-recover its 2013–14 DUoS target by $111.0 million, which will be recovered in 2015–16. It also expects to seek pass throughs for under-recovered capital contributions in 2013–14*

($47.3 million) and 2014–15 ($37.2 million), which will be recovered in 2015–16 and 2016–17 respectively."[2]

Further, major payment defaults are not expected to occur without warning and distributors are likely to have the capacity to firm up additional funding requirements to cover any potential shortfall before a failure eventuates. A review of Distributor's Annual Reports shows distributors appear to have sufficient working capital amounts that could be called upon at short notice. For example, Essential Energy had $363 million of undrawn debt facility at the 30 June 2016, Endeavour had $292 million and Ausgrid had $525 million at 30 June 2016[3]. This suggests that distributors will be able to manage significant revenue shortfalls through their current funding arrangements.

It is thus clear that revenue risk is eliminated given the preferable Rule, distributors are able to adequately cover liquidity risk and thus broader systematic risk is mitigated.

Closing

In light of the work undertaken by the AEMC, Origin agrees that it is clear that it is more efficient for distributors to manage any short fall funding as part of their current debt portfolio arrangements rather than other parties seeking to obtain funding. This will ensure costs are only incurred by customers and the market when a retailer failure eventuates. Origin thus supports the proposed preferable Rule changes as proposed by the AEMC and we believe the market will benefit from such amendments.

Should you wish to discuss the contents of this response, please contact Caroline Brumby (Regulatory Manager) on (07) 3867 0863 in the first instance.

Yours sincerely

Keith Robertson
Manager, Wholesale and Retail Regulatory Policy
(02) 9503 5674 Keith.Robertson@Originenergy.com.au

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[2] AER, Energex determination 2015−16 to 2019−20 Final Decision, Attachment 1 − Annual Revenue Requirement, October 2015, p11.
[3] Essential Energy, Annual Report 2015-16, p66; Endeavour Energy, Annual Report 2015-16, p61; Ausgrid, Annual Report 2015-16, p47.