energy networks association

20 December 2012

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

via website: submissions@aemc.gov.au

Dear Mr Pierce

EMO0024 – NEM financial market resilience – Response to Options Paper

Thank you for the opportunity to make a submission in response to the AEMC's EMO0024 – NEM financial market resilience – Options Paper released on 9 November 2012.

In its assessment of options for addressing NEM financial market resilience in the case of the financial distress or failure of a large electricity retailer the ENA would like to reiterate the critical role of Distribution Network Service Providers (DNSPs) and Transmission Network Service Providers (TNSPs) in the customer supply chain.

The key issue for DNSPs is the credit risk and cash flow implications associated with their supply of large volumes of network services to a very small group of 'big' retailers. Given that DNSPs are regionally based the problem is exacerbated because individual DNSPs typically have a large proportion of their customer base associated with the local retailer. There is also a high risk of potential flow-on effects to customers and other market participants from the failure of a large retailer and the inability of the existing Retail of Last Resort (RoLR) arrangements to work in practise, i.e. agreed steps are needed to head off contagion.

While the existing RoLR scheme has proven satisfactory in the event of the failure of a small retailer it is unlikely that this would be the case for a failure of one of the large retailers due to the magnitude and complexity of the task in transferring customers from one retailer to another and management of the credit risk and cash flow necessary for the financial security of the DNSP. The task needs to be completed in a very short time frame in order to maintain orderly market operations and to deal with the potentially massive backlog of payments, as there is no clear link between non-payment to DNSPs and ROLR declaration. This was illustrated in the Jackgreen insolvency case as noted in the Options Paper.

As an example a nominal DNSP with annual revenue of $2 billion is raising invoices to the value of $38 million each week. Assuming 50% of its customers are with the local retailer then approximately $19 million each week (50% of its revenue) is assumed in its cash flow planning to maintain operations. A delay of more than a few days in receiving payments from the new retailer will cause cash flow deficiencies which could result in serious consequences for the DNSP. This impost is in addition to a shortfall of up to 4 weeks payments from the failed retailer (in this case $76 million) in relation to the immediate billing period and also any default on payment in earlier billing periods before ROLR declaration.

Whilst this is subject to Credit Support Regime bank guarantees, the relatively low level of coverage to the notionally stable large retailers does not mitigate the cash flow issue for DNSPs materially.

Everything necessary to avoid contagion on the collapse of a 'big' retailer is necessary, and ENA supports the toolkit approach proposed in the Options Paper which allows a potential situation to be mitigated at different points in its development.

However, the 4 options outlined in the Options Paper only provide limited recognition of the severe impact on DNSPs in the event of the failure of a large retailer. In particular Options 6.2 and 7.4, if adopted, would increase the risks to DNSPs, especially where, as mentioned above, their local retailer fails a DNSP is dependent upon this single retailer for a large proportion of its cash flow.

ENA notes that in establishing the NECF, Rules Changes relating to cost pass-through in the event of a retailer insolvency event have created uncertainty regarding the ability of DNSPs to recover unpaid network charges via this mechanism. It appears that not all amendments to the Rules agreed through the Joint Implementation Group which would clarify that full recovery is intended have been implemented. Whilst this situation needs to be addressed, the current ambiguity should be taken into account in the AEMC's consideration of the risks to DNSPs arising from the various options presented (see clause 6.6.1(m) of the National Electricity Rules).

We also note that the transfer of additional revenue risk to DNSPs is not consistent with the sector's status as a regulated monopoly service provider, and has other, indirect impacts. For investors seeking stable and predictable investments, an altered risk profile may impact on their view of the sector, and impacting on financing costs.

Because of the low probability of a large retailer default together with the potentially severe effects this may cause, the options in Chapter 5 (options to improve the RoLR regime) and Chapter 8 (options for a last resort government response) would appear to provide a more secure environment to maintain DNSP and TNSP services than the options set out in Chapters 6 (options to address the designated RoLR's increased credit support obligations) and 7 (options to address the designated RoLR's increased costs and risks).

For the continuity of a safe electricity supply, the financial security of the DNSP must be maintained and any of the mechanisms put in place must be able to demonstrate how it supports this.

The ENA is the peak national body for Australia's energy networks, which provide the vital link between gas and electricity producers and consumers. The ENA represents gas distribution and electricity network businesses on economic, technical and safety regulation and national energy policy issues.

Energy network businesses are valued at more than $60 billion, annually undertake investment of more than $6 billion in network maintenance and expansion, have annual revenue of over $20 billion and employ 40,000 staff.

If you have any questions please contact Jim Bain on 02 6272 1516. We look forward to the release of your interim report providing draft advice to SCER in early 2013.

Yours sincerely

Malcolm Roberts
Chief Executive