3 July 2015

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

energex
positive energy

Dear Mr Pierce

ERC0183: National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015

Energex welcomes the opportunity to comment on the AEMC's consultation paper on the proposed rule change by AGL to amend the retailer-distributor credit support requirements in the National Electricity Rules (NER).

Energex notes the decision to consolidate the Council of Australian Government Energy Council's (COAG Energy Council) retailer insolvency cost pass-through rule change request with AGL's rule change request. Energex strongly supports the retailer insolvency pass through rule change; however, Energex has concerns that the consolidation of the two rule change requests may unnecessarily delay the resolution of the retailer insolvency pass through, which is effectively the correction of an error.

The adequacy of the current credit support regime and the ability for distributors to effectively mitigate the risk of retailer default are important issues in the long term interests of consumers. Credit support arrangements between distributors and retailers support the integrity of the electricity market in much the same way that the prudential arrangements that the Australian Energy Market Operator manages between generators and retailers.

Energex strongly supports the assertion that there are deficiencies in the current credit support arrangements, particularly in that it fails to allocate retailer credit risk to the party who can best manage it (i.e. the retailer) or to provide distributors with adequate means to manage such a risk. Under the current credit support provisions, Energex cannot request any credit support from the 27 retailers with whom Energex must provide electricity distribution services to, despite a current total network charges liability of almost $450 million.

An example of how the current credit support provisions are clearly ineffective is how a retailer who has a credit risk rating of 'Very High' (on the Dun & Bradstreet risk score), does not have to provide credit support as their network charges liability does not exceed their credit allowance of $16.5 million. Such an outcome clearly does not contribute to the National Electricity Objective (NEO) by promoting efficient investment in, and efficient operation of electricity services for the long term interests of consumers.

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This particular issue could be improved through a review of the table in Schedule 6B.1 of the NER to realign the Dun & Bradstreet probability of default to the Standard & Poor/ Fitch/ Moody's probability of default as the current misalignment results in unrated retailers provided unrealistic credit allowances.

Recognising that the current regime is ineffective and in considering an alternative approach, Energex believes that the credit support provisions in the NER should take into account both the likely default of an individual retailer (based on their credit rating and payment history) and the distributor's level of exposure to an individual retailer. We believe that neither the AGL rule change nor current credit support provisions address either.

The level of risk and financial market resilience is significantly increased in instances where one or two retailers have a large market share of a distributor's business. Therefore, lowering the probability of default benchmark to BBB- increases a distributor's risk if a large retailer or a retailer with a rating greater than BBB has significant market share and defaults.

Distributors have limited access to alternative avenues to mitigate the risk of credit default or recover costs associated with a retailer failure. The pass through provisions in the NER are one such avenue, however, it is important that the proposed rule change for a retailer insolvency event pass through with a 'no materiality' threshold is introduced as soon as possible. This rule change is necessary to rectify an inadvertent amendment to the NER that resulted in a misalignment with the original policy intent when the National Energy Customer Framework was introduced but also because a retailer insolvency event does not represent an increase in the costs of providing direct control services.

However the most effective way of mitigating the potential credit and cash flow impacts from a retailer failure is through having effective credit support arrangements that can be enforced by distributors. The most efficient outcome that would best promote the NEO is to give retailers an incentive to maintain or improve, as far as possible their credit rating, which the current rules do not encourage.

Energex is a member of the Energy Networks Association (ENA) and is supportive of the views and recommendations contained in the ENA's submission. Energex looks forward to further engaging with the AEMC on this matter and if you require any information please do not hesitate to contact Ms Nicola Roscoe, Network Regulation Manager, on (07) 3664 5891.

Yours sincerely

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