29 November 2016

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

AEMC Reference: ERC0183; GRC0032

Dear Mr. Rai

RE: Retailer-Distributor Credit Support Requirements Draft Rule Determination

ERM Power Limited (ERM Power) welcomes the opportunity to respond to the Australian Energy Market Commission's (the Commission) Draft Rule Determination on retail-distributor credit support requirements.

About ERM Power Limited

ERM Power is an Australian energy company operating electricity sales, generation and energy solutions businesses. The Company has grown to become the second largest electricity provider to commercial businesses and industrials in Australia by load[1], with operations in every state and the Australian Capital Territory. A growing range of energy solutions products and services are being delivered, including lighting and energy efficiency software and data analytics, to the Company's existing and new customer base. ERM Power also sells electricity in several markets in the United States. The Company operates 497 megawatts of low emission, gas-fired peaking power stations in Western Australia and Queensland. www.ermpower.com.au

The Draft Determination

ERM Power strongly supports the Draft Rule Determination and considers the Commission has taken a balanced and reasonable approach in deciding how to allocate the risks of retailer default with the impacts to customers and markets. The Commission has proposed more preferable rules to enhance the retailer insolvency cost pass-through provisions and remove credit support requirements, except in the case of late payment. In doing so, we concur with the Commission's statement:

> *The draft rules provide regulatory certainty to retailers, distributors, other market participants and the financial markets regarding the regulatory mechanisms available to distributors to manage the risk they face from retailer default.[2]*

As we have highlighted previously through a submission to this rule change proposal, we believe the objective should be to achieve an acceptable level of risk mitigation at lowest cost. We are pleased that the Commission has considered the importance of minimising ongoing costs to consumers through establishing effective means of recovering distributors' lost revenue post-default.

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[1] Based on ERM Power analysis of latest published financial information.

[2] AEMC 2016, Retailer-distributor credit support requirements, Rule Determination, 27 October 2016, Sydney, pg. ii

Ex-post recovery provides the most efficient and effective mechanism

ERM Power has previously raised concerns over proposed ex-ante mechanisms to manage the risks associated with retailer default in the options paper consultation. Options such as the retailer fund and ratings-based credit support potentially places disparate costs on industry participants and customers, and can reduce competition with barriers to entry. Ex-ante mechanisms may produce a less efficient outcome whereby costs of risk mitigation are levied on customers through higher tariffs. In contrast, an ex-post approach provides a compelling mechanism for addressing risks at lower cost, whereby distribution businesses are able to recover unpaid network charges after the default. The likelihood of costly over recovery is reduced as only actual costs are recovered. We therefore support the Commission's approach to meet any unpaid network charges through enhancing the operation of the retailer insolvency cost pass-through provisions.

An ex-ante approach requiring credit support provision also threatens the competition principle[3], and may produce further negative outcomes to customers. Requirements for lodging support may be disproportionate to the risk and may generate a competitive disadvantage to a class of retailers who are forced to pass through higher credit support funding via their tariffs. We fully support the more preferable rules that remove the requirements for a retailer to provide any form of credit support to a distributor except in the case of a history of late payment of distributor's invoices. We consider that this approach deals appropriately to heightened risk observed through payment behaviour and addresses concern of barriers to entry.

Distributors are best placed to manage liquidity risk (if any)

One important aspect of the Draft Determination is recognition by the Commission that distributors, as monopoly providers, are best placed to control and manage liquidity risk arising from a retailer default. We welcome this finding as we have been particularly concerned with the supposition of previously presented options, that lower rated (and likely smaller) retailers shoulder the greater proportion of ex-ante mitigation funding when in fact such retailers would have much lower liquidity impact should default occur. We agree with the Commission's assessment that distributors are better equipped and positioned to manage cash flow issues arising from default through existing mechanisms, the proposed enhanced cost pass-through provisions and regulated income.

Please contact me if you would like to discuss this submission further.

Yours sincerely,

[signed]

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[3] As part of the assessment into the various options presented, the AEMC had regard to the principle of ensuring the rule takes into account the potential impact on barriers to entry and competition for retail businesses. See AEMC 2016, Retailer-distributor credit support requirements, Rule Determination, 27 October 2016, Sydney, pg. iv