Ms Anne Pearson
Senior Director
Australian Energy Market Commission (AEMC)
Level 6, 201 Elizabeth Street, Sydney NSW 2000

2 July 2015
REF ERC0183

Dear Ms Pearson

Re: Consultation Paper - National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015

This submission is prepared jointly by the following energy retailers:

- Blue NRG
- Sumo Power
- dodo Power & Gas and Commander Power & Gas
- Qenergy Limited
- Click Energy
- Next Business Energy

We welcome the opportunity to comment on the Australian Energy Market Commission's (AEMC) Consultation Paper - National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 and National Gas Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 (the 'consultation paper').

Background

The AEMC's consultation paper considers a proposal by AGL (the Proponent) to amend the retailer – distributor credit support requirements under the National Electricity Rules (NER) and National Gas Rules (NGR). The effect of this proposed change is that gas and electricity retailers with a BBB+ credit rating (or above) would not be required to provide credit support. Retailers with a BBB- or lower credit rating would be required to provide credit support.

The consultation paper discusses general considerations to manage risk of retailer non – payment and canvasses several other mechanisms to reduce distributor exposure, including:

- recovery through the regulatory determination process
- recovery through the cost pass through mechanism
- recovery through the corporate insolvency process
- minimising a retailer's network charges liability

General considerations

As noted in the consultation paper, all businesses face commercial risks.[1] The consultation paper

[1] AEMC, Consultation Paper, National Electricity Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015 National Gas Amendment (Retailer-Distributor Credit Support Requirements) Rule 2015, page 3.

notes that the main commercial risk faced by distributors is the failure of a retailer to pay its network charges.[2]

Notwithstanding this, we do not support the Proponent's proposed rule change. It is not clear from the consultation paper that any inherent problem exists with the current credit support regime, and we believe that the credit risks to which a distributor is exposed can be managed through the current rule structure. Indeed, this framework and its antecedents have supported the establishment of many genuine retail competitors in the National Electricity Market – including all of our companies – as well as the orderly outworking of retailer insolvency in the case of JackGreen. In our view, the current rule structure appropriately balances both the likelihood and the impact of potential retailer insolvency loss to distributors through the use of a credit-related scale that applies above a materiality threshold.

We have a number of concerns with the changes proposed by the Proponent including:

- We do not consider that the proposal differentiates appropriately between addressing the creditworthiness of a small retailer, which drives the likelihood of any impact on a distributor, and the impact on that distributor once it has occurred, which is related to the size of the exposure. In particular, the proposal does not cater for the cascading impact of the failure of a large retailer on a distributor, as opposed to the discrete impact of the failure of a small retailer.
- We do not agree with any proposition that the current credit support arrangements result in a shift of the burden of credit support from low-rated retailers to high-rated retailers. The current rule structure takes into account the creditworthiness of the retailer in question, so in our view, the Proponent is reacting to the burden of credit support that accrues to a large retailer whose exposure is above the maximum credit allowance. This maximum credit allowance is available to all retailers, and the Proponent along with all others has the benefit of a reduced credit support requirement because of the operation of the maximum credit allowance. Further, the Proponent has the benefit of lower credit support requirements above their maximum credit allowance as a result of their investment grade rating. It is a separate issue that most large retailers whose exposure is above the maximum credit allowance are in possession of an investment grade rating.
- We are also concerned that the proposal may confuse retailers' needs to manage a formal credit rating with their management of their own creditworthiness. Whilst relatively few electricity retailers have a formal credit rating, all retailers are incentivised to manage their creditworthiness. Indeed, some smaller private retailers may well have better creditworthiness than their larger competitors, but do not have a formal credit rating. Improved creditworthiness leads to more choice and lesser requirements to post credit support with generation counterparties, and underpins retail operations including access to finance. Because of the fundamental drive of any retailer to manage their creditworthiness, we disagree that further rules to manage retailer default will positively impact on a retailer's operational decisions.
- We would be particularly concerned if the proposed rule change were to peg outcomes to a

[2] Ibid.

formal credit rating process, which is narrower, more expensive and onerous, and less applicable across the electricity market than the current assessment methodology. Ultimately, it is a retailer's creditworthiness that determines the likelihood of retailer default and a formal credit rating is only one measure of their creditworthiness. We are supportive of the other, broader processes embodied within the current rule structure, and would point to their similarity to the processes used by other authorities to support the maintenance of retail licenses (for example, jurisdictional retail licenses or an Australian Financial Service Licence) and market registration.

- A corollary concern is that the proposal will lessen competition by increasing the barriers to entry for small entrants. Whilst the proposal decreases prudential support for larger but highly rated entities, it increases the potential prudential support requirements from smaller but lesser rated entities. This potentially imposes an additional level of capital required to commence electricity retailing, which not only may increase costs but most importantly simply may not be able to be accessed, hence stifling competition.
- We are concerned that the proposed change is a shift away from the current regulatory framework which was the framework upon which investment decisions including customer acquisition have been based by companies such as ours in the electricity market. Imposing such a change which has a significant risk of impost on existing small retailers is a regulatory risk which would both unfairly create burdens for existing retailers and create uncertainty for new retailers.
- The proposal asserts that the NEM has seen a significant decline in the incidence of high price events due to changes in the supply-demand balance and that this should be a basis for modification of the rules. We reject this assertion and are firmly of the view that NEM activity has continued to remain volatile and therefore the rationale for the current rules has not altered since it was implemented. As an example, the Summer period in Queensland saw two record new high-priced days, with the daily price on 17 December 2014 70% higher than the previous December record, and that on 5 March 2015 being 33 times the previous March record.
- The proponent has also assumed certain tolerances from customers regarding the proposed change (specifically section 4 page 10). We believe that assumptions regarding customer tolerances should be tested before a change of such significance is implemented. Customers have benefited from the increased competition that has been offered by allowing smaller entities to compete in the national electricity market and this benefit has not been assessed or quantified in any way in the proponent's submission. To propose a move away from the current arrangements without testing this key assumption is in our view a very significant concern.

Other mechanisms available under the regulatory regime better manage the risk of retailer non-payment because they avoid unnecessary barriers to entry, whilst still being consistent with both the National Electricity Objective (NEO) and National Gas Objective (NGO). This should be a key consideration in managing this risk, as it will create equitable outcomes for all market participants.

Our responses to several specific questions are set out below, along with general comments on the Proponent's proposed rule change and the management of risks associated with retailer non-payment.

Responses to specific questions

In response to question 2, we broadly agree with the AEMC's proposed principles for designing a rule for managing the risk of retailer non-payment, although the requirement to take into account the trade-off between flexibility and regulatory certainty could be strengthened by explicitly recognising the need to minimise the 'sovereign risk' which would accrue if a business rule as fundamental as capital adequacy requirements was altered.

Any proposed measures to mitigate risks of retailer non-payment should be balanced against the likelihood and magnitude of such risk. Such measures should avoid any potential barriers to entry for market participants. We consider that the Proponent's proposed rule change may have consequences for market competition by creating unnecessary barriers to entry by placing unnecessary financial pressure on retailers. If market entry is stifled because of this pressure, the long-term interests of consumers are compromised. Further, an assessment of a retailer's risk of non-payment based on credit rating alone appears arbitrary when many other factors may affect the likelihood of retailer non-payment.

In response to question 8, it is pertinent to consider that new entrant retailers are already subject to financial assessment by the Australian Energy Regulator (AER) and, in the case of Victoria, the Essential Services Commission of Victoria (ESCV) for jurisdictional retail licenses, and by the Australian Securities and Investment Commission (ASIC) for the granting of an Australian Financial Services License. This provides a level of market surety on a retailer's financial position and takes into account the potential retailer's credit rating as well as a range of other financial health indicators and does not require the retailer to obtain a formal credit rating.

In response to question 10, recovery through the regulatory determination process may prove difficult, particularly given that these events are rare and costs are likely to vary depending on circumstance. Any ex ante allowance or self-insurance allowance would, as noted in the consultation paper, be difficult to quantify in advance. Any allowance in the regulatory determination would also mean that end users are paying a higher price than is required for the efficient use of the distribution system over the regulatory period if no retailer non-payment event occurred. This would appear inconsistent with the NEO and NGO.

In response to question 11, recovery through the cost pass-through mechanism appears to be a workable solution. Cost pass-throughs can also potentially be used in hybrid with other mechanisms. Retailer insolvency or non-payment carries the potential for a high magnitude consequence for the distributor (particularly where the retailer is large, in which case there might be even further indirect cascading impacts), but has a relatively low likelihood of occurrence. A pass-through option would allow a full recovery of associated costs *when and if they occur* (subject to any materiality threshold), ensuring that end users are not paying for costs not incurred.

Cost pass-throughs also avoid difficulties associated with quantifying costs of non-payment or insolvency in advance. A cost pass-through would allow costs to be absorbed across a larger group of customers (who ultimately benefit from increased market competition). A potential method to maximise the efficiency of the cost pass-through mechanism is to permit a cost pass- through only where the distributor has been unable to recover costs through other mechanisms (for example, through corporate insolvency processes).

In response to question 12, it would appear that recovery of non-payment costs through the corporate insolvency process still presents some residual risk if the distributor is unable to recover its costs in full. As noted above, corporate insolvency could be used as a primary cost recovery mechanism with a cost pass through used as a 'fall back'.

In response to question 12, the option of more frequent billing or the retailer paying its network charges in advance would require the retailer to access additional working capital and would also drive systems redesign, once again representing a real regulatory risk to existing businesses. Further, these options would also seem to present an unnecessary barrier to entry by creating potential cash flow and capital access issues for new entrant retailers.

Summary

The risk of non-payment by retailers is a risk that is already addressed by the existing regulatory framework. To the extent that regulatory change is required to better allocate that risk, we consider that a number of options exist that better balance the risk of retailer failure and the broader market objectives of increasing market competition and reducing barriers to entry when compared to the proposal put forward by the Proponent.

We look forward to engaging in further discussions with the AEMC on this issue and providing further comment in this area. Should you have any questions about this submission, please contact our coordinator Naomi Feast, Manager Regulatory and Compliance, Blue NRG on 03 8888 3305.

Yours sincerely

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