Att: John Pierce
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235
Lodged electronically

2 July 2015

Dear Mr Pierce

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

QEnergy welcomes the opportunity to respond to the proposed rule change in relation to *Retailer – Distributor Credit Support arrangements*.

QEnergy has a number of concerns with the changes proposed by the proponent, and believes that the credit risks to which a distributor is exposed can be managed through the current rule structure. QEnergy does not believe the current rule structure warrants fundamental change, since this framework and its antecedents have supported the establishment of genuine retail competitors in the National Electricity Market, as well as the orderly outworking of retailer insolvency in the case of JackGreen. In QEnergy's 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.

To finesse the current structure, QEnergy would support the proposed rule change as submitted by the COAG Energy Council that seeks to remove the materiality threshold for recovery of costs in the event of a retailer insolvency as was intended but omitted under the introduction of the NECF. QEnergy would also support cost recovery by distribution network companies for the provision of credit support.

QEnergy's key concerns with rule change as submitted by the proponent are as follows:

- QEnergy does 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.
- QEnergy does 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 QEnergy's 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 they along with all others have 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.
- QEnergy is 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 to underpin their operations

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including access to finance. Because of the fundamental drive of any retailer to manage their creditworthiness, QEnergy disagrees that further rules to manage retailer default will positively impact on a retailer's operational decisions.

- QEnergy would be particularly concerned if the proposed rule change were to peg outcomes to a 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. QEnergy is 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.
- QEnergy is 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. Imposing such a change which has a significant risk of impost on existing incumbent 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. QEnergy rejects this assertion and is 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). QEnergy believes 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.

QEnergy's responses to the questions as posed in the rule change consultation paper are attached. Please feel to contact me if you have any queries in relation to this submission.

Yours sincerely

Kate Farrar
Managing Director

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

Question 1 Current credit support requirements

(a) *Do distributors request credit support in all circumstances permitted under the current arrangements?*

Under the rules, QEnergy has not been required to post credit support to date and so cannot comment.

Question 2 Identification of Appropriate Principles

(a) *Are these principles appropriate for designing a rule for managing the risk of retailer default?*

In QEnergy's view, the requirement to take into account the trade-off between flexibility and regulatory certainty should explicitly recognise the need to minimise the 'sovereign risk' which would accrue if a business rule as fundamental as capital adequacy was altered.

(b) *Are there other factors market participants would expect to be considered in an effective rule for managing the risk of retailer default?*

The impact on the business of a less well capitalised retailer from such a rule change needs to be considered. That is, the imposition of an additional liability may have an increased likelihood of triggering a default rather than protecting against it.

Question 4 Management of risk to reduce costs

(a) *Do the costs imposed on retailers by the current rules (or potentially by the proposed rules) lead retailers to take actions to better manage their risks in order to reduce their costs?*

The current rules provide a pragmatic and realistic mechanism to call on credit support based on the occurrence of default events. This is an evidence-based approach that provides a realistic trigger for the distributor to call on credit support. Under the current structure, the NEM has seen both an increase in the number of competitive retailers and the orderly continuity of the market following JackGreen's default.

(b) *Do the risks borne by electricity distributors under the current rules (or potentially by the proposed rules) lead distributors to take actions to better manage the risk of retailer default?*

QEnergy considers that the current rule structure has motivated distributors to maintain early and open communication with retailers about upcoming environmental and price changes, as well as to ensure prompt and accurate billing. Both of these elements are key supports by distributors in managing the risk of retailer default.

(c) *Do the costs imposed on consumers by the current rules (or potentially by the proposed rules) lead consumers to make informed decisions about purchasing electricity or gas from their retailer?*

Any increase in potential credit support may serve as a barrier to entry for smaller, less well capitalised retailers. This is likely to reduce competition and increase customer prices. Consumers currently understand the risk of retailer default when they move to a smaller, less well capitalised retailer but opt to take the savings offered by the competitive process. In QEnergy's view, consumers are under the current rules making informed decisions about purchasing electricity from their retailer.

Question 5 Reducing risk of non-payment

(a) *What operational decisions could retailers make to reduce the risk of their own default on payments to distributors?*

Retailers already make operational decisions throughout their businesses to reduce the risk of default to distributors. The current mechanism requires retailers to place meeting their payment obligations to distributors as a top priority, otherwise additional credit support could be called upon.

(b) *Would retailers undertake these operational decisions if the rule to manage the risk of retailer default did not impose a credit support requirement?*

The current credit support requirements ensure that retailers place meeting their payment obligations to distributors as a top priority, and the avoidance of provision of additional credit support is a key motivating factor for retailers.

Question 6 Purpose of Rule

(a) *Is this the correct approach to consider the level of protection to be provided by a rule to manage the risk of retailer non-payment?*

QEnergy considers that the rule should consider the likelihood – creditworthiness – and impact – size of exposure adjusted for any additional cascading risk from a large retailer default.

(b) *Are there any other protections provided by a rule to manage the risk of retailer non-payment?*

No.

Question 7 Changes in the calculated amount of credit support required

(a) *How do frequent changes in credit support requirements affect retailers?*

Uncertainty is negative for any business, large or small. Frequent changes to capital requirements would mean that retailers would be required to hold capital in excess of requirements to cater for the risk of an unforeseen call, which would add further to barriers to entry for smaller retailers, thus reducing competitive pricing tensions, and would also directly increase costs.

(b) *How could other approaches to a rule for managing the risk of retailer default improve regulatory certainty or flexibility?*

QEnergy considers that the current credit support arrangements appropriately manage the risk of retailer default, and provide sufficient regulatory certainty.

Question 8 Barriers to Entry

(a) *Are credit support requirements a barrier to entry or expansion for small retailers?*

The requirement to provide credit support is a barrier to entry and expansion for small retailers, both in terms of capital access and cost.

(b) *What control do small retailers have over their credit support costs when entering the market?*

Under the current rules, small retailers are able to manage their growth in each distribution area such that they do not exceed the maximum credit allowance. This means that customers are able to access the benefits of competitive pricing, and the impact on distributors is quarantined in the unlikely event of a retailer default. It also minimises credit support costs for small retailers.

(c) *Would other ways of reducing a retailer's liability reduce the barriers to entry or expansion faced by small retailers?*

The current mechanism for invoking credit support upon the occurrence of default events allows for small retailers to manage their costs and provides an effective lever to distributors when there is an actual default.

Distributors face retail failure risk, which is large. However, they have very low trade credit risk which retailers assume on their behalf every day and for which retailers receive no allowance. One possible area would be to provide network cost relief to retailers for the implementation of hardship programs.

Question 9 Balance of credit risk and impact risk

(a) *Is AGL's proposal an improvement over the current credit support requirements?*

QEnergy has a number of concerns with the changes proposed by the proponent, and believes that the credit risks to which a distributor is exposed can be managed through the current rule structure. QEnergy does not believe the current rule structure warrants fundamental change, since this framework and its antecedents have supported the establishment of genuine retail competitors in the National Electricity Market, as well as the orderly outworking of retailer insolvency in the case of JackGreen. In QEnergy's 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.

(b) *Given your answer to a), explain why or why not.*

QEnergy does 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 therefore 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.

Similarly, QEnergy does not agree 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 QEnergy's 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 they 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 reduced credit support requirements above their maximum credit allowance because of their investment grade rating. Despite this, however, 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.

QEnergy is also concerned that the proposal may confuse retailers' need 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 to underpin their operations including access to finance. Because of the fundamental drive of any retailer to manage their creditworthiness, QEnergy disagrees that further rules to manage retailer default will positively impact on a retailer's operational decisions.

QEnergy would be particularly concerned if the proposed rule change were to peg outcomes to a 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. QEnergy is supportive of the other, broader processes

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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.

QEnergy is 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. Imposing such a change which has a significant risk of impost on existing incumbent 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. QEnergy rejects this assertion and is 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). QEnergy believes 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.

Question 10 Recovery through the regulatory determination process

(a) *What are the advantages of the regulatory determination process in terms of recovering revenue related to managing the risks associated with retailer default?*

The regulatory determination process for the recovery of credit risk insurance premiums is a sound methodology for fairly distributing an identified cost across the market.

(b) *How does this mechanism compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default?*

QEnergy believes that credit risk insurance is an effective mechanism to manage retailer credit risk.

Question 11 Recovery through the cost pass-through mechanism

(a) *What are the advantages of the cost-pass through mechanism in managing the risks associated with retailer default?*

QEnergy supports this change and supports the view of COAG that this change should be implemented as intended under NECF.

(b) *How does this mechanism compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default?*

The cost pass through mechanism is preferable to any increase in credit support requirements which would increase barriers to entry for small retailers and reduce competition, thus increasing costs.

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Question 12 Recovery through the corporate insolvency process

(a) *What role does the corporate insolvency process play in providing a sufficiently effective and transparent means of managing retailer default?*

The RoLR Rules provide for all outstanding load of the retailer to be invoiced upon an insolvency event. Thus, a significant proportion of the then outstanding trade debtors will be recovered in the ordinary course of business.

How does this mechanism compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default?

Provided that there are no large scale issues with the retailer's billing system, this is an efficient method for recovering outstanding liability to a distributor.

Question 13 Management of risk through the minimisation of network charges liability

(a) *What are the advantages of mechanisms to minimise a retailer's network charges liability in managing the risk of retailer default?*

These mechanisms are a less effective means to manage the risk of retailer default and would involve considerable operational implementation and significant adverse cash flow impacts on retailers which would not be warranted.

(b) *How do these mechanisms compare to other alternatives available to distributors and/or retailers to manage risks associated with retailer default?*

These mechanisms are less effective than other alternatives available.

(c) *Are there any practical considerations of developing and implementing mechanisms to minimise a retailer's network charges liability? If so, what are these considerations?*

There are considerable practical considerations in implementing these mechanisms such as changes to meter reading and billing cycles. There are more effective mechanisms available that do not require such significant operational change.

Question 14 Relationship between mechanisms to manage the risk of retailer default

(a) *How do the various mechanisms available to manage the risk of retailer default work to complement each other in ensuring that the risk of retailer default is managed in the most efficient manner?*

QEnergy does not support significant change to the current mechanisms which operate effectively to manage retailer credit risk.

(b) *How should these different mechanisms be combined in a regime to manage the risk of retailer default to ensure an efficient outcome?*

QEnergy's view is that the current default based mechanism for invoking credit support, together with the availability of credit risk insurance (and the regulatory recovery of this through the regulatory process) provide for an efficient outcome in protecting against exposure to retailer default.

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