

7 July 2016

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

National Electricity Amendment (Market Participant Suspension Framework) Rule 2016

Dear Mr Pierce

The Energy Networks Association (ENA) welcomes the opportunity to make a submission to the Australian Energy Market Commission (AEMC) in response to the *National Electricity Amendment (Market Participant Suspension Framework) Rule 2016* published by the AEMC on 9 June 2016.

The ENA is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia.

The ENA agrees with the AEMC that "the rule change request relates to financial stability, because the decision to allow a market participant in financial distress to continue operating can have significant financial impacts on the market" and we note that this has significant potential financial implications for network service providers.

If retailers are to continue trading in the national electricity market (NEM) whilst under external administration, this must only occur in association with the removal of the materiality threshold; currently the subject of a separate rule change process. As the AEMC is aware, in the event of retailer default, network service providers (NSPs) may be restricted in their ability to recover costs to circumstances where these costs exceed one per cent of the distributor's revenue requirement for that year. This means that under this rule change proposal and the rules as they currently stand; NSPs will be required to extend further credit to a retailer in financial difficulty and expose themselves to significantly higher losses and levels of risk, within a market framework that may prevent any losses from being recovered. This is clearly an unacceptable position to force upon NSPs and must be rectified prior to this rule change commencing.

ENA notes and supports COAG's proposal that when determining a retailer's capability to continue trading under administration, AEMO must consider the retailer's source of "guaranteed funding to meet any trading amounts". However, we do not consider this measure alone provides sufficient protection to NSPs or reflect an equitable level of risk management between market participants. While guaranteed funding may be available to retailers to meet their trading obligations, if liquidation were to occur such funds are frozen at which point there is no assurance that either the outstanding debt will have been, or will be paid. NSPs at any given time can be owed tens of millions by a retailer and allowing retailers to increase their debt level when under administration requires protection for NSPs to recover any and all losses, or risk financial contagion. This is particularly so as new and existing retailers begin to offer new

and innovative products in the market, likely increasing their exposure in the process. As such, if this rule change proceeds, it is imperative it do so in conjunction with the removal of the materiality threshold, or, come into force after the retailer credit support rule change (assuming this rule change determines to remove the materiality threshold) is finalised.

Further we are concerned that the proposed suspension framework may give rise to broader financial uncertainty in the market. This is because, in the case of the failure of a vertically integrated gentailer, customers (NMI's) of the failed retailer may be transferred to a Retailer of Last Resort (RoLR). The creditors (NSPs and others) would still have claims against the entity with the generation assets, where deeds of cross guarantee are in place between related entities. Therefore, there is a risk of financial contagion as the Australian Energy Market Operator (AEMO) will not have full visibility (or power) over all of the market participant's businesses/subsidiaries in order to mitigate financial distress in the national electricity market (NEM).

This is of particular concern because we note that, while not explicitly discussed in the AEMC's Consultation Paper, there are proposed changes to the Rules to exclude shared customers from a failed retailer from the designated RoLR's network charges liability calculation undertaken by NSPs to determine the RoLR's credit support requirements (proposed drafting changes to clause 6B.B2.3).

Any changes to the credit support regime need to be considered holistically. We have previously advocated a strengthening the existing credit support regime and have raised this in previous submissions to the current AEMC consideration of the *Retailer-Distributor Credit Support Requirements Rule Change* as well in the *NEM Financial Resilience Review*. We reiterate the points made within the rule change consultation process, and which we understand the AEMC is now considering, that the credit support Rules should be improved by addressing several important issues, namely:

- » The three largest retailers each have a Standard & Poor's (S&P's) corporate credit rating which apply to the consolidated entity, its group financial results and risk structure. Each of these large energy retailers operate under multiple financially responsible market participants (FRMP) and various legal entities. However, a retailer (or retailers) within the group may seek to rely on the corporate credit rating for the rated FRMP and a Dun & Bradstreet dynamic risk score for the other un-rated FRMP's, thereby availing the retailer of multiple credit allowances, resulting in the DNSP having no or inadequate credit support.
- » In order to address this problem, the current clause 6B.B3 of the Rules would need to be amended to explicitly state that the applicable credit support allowance can only be obtained for the parent retailer based on their credit rating and that credit allowance apportioned to the related entities/ FRMPs within a retailer group, so that retailers can no longer receive multiple credit allowances for un-rated subsidiaries. That is, where a FRMP(s) or authorised retailer(s) is a part of a large rated entity, the credit rating assigned by S&P's, Moody's or Fitch applies at the corporate level and the NSP will determine how the credit allowance will be apportioned amongst the retailers within the group (based on the methodology prescribed in the Rules).
- » The ENA queries whether the condition proposed in paragraph 116 of the COAG paper provides sufficient confidence to the market, as AEMO would at the time be considering suspension of one registration of a market participant. The ENA suggests that text such as "and taking into account the cause and implications of suspension of a related market participant" should be added.
- » While credit ratings incorporate dynamic measures of risk, they do not address the single name concentration risk that DNSPs have to the largest three retailers within the NEM.
- » As such, the ENA recommends the inclusion of a concentration premium 'add on' that should be applied to the current provisions such that the credit support requirement captures single name credit concentration risk as well as the risk of default.

- » The current Rules Table in Schedule 6B.1 (Clause 6B.B3.1) misaligns the Probability of Default of Dun & Bradstreet to Standard & Poor's and, as a result, gives unrated retailers unrealistic credit allowances. It is the ENA's position that the Rules should realign the Probability of Default of Dun & Bradstreet to Standard & Poor's/ Fitch/ Moody's probability of default. In addition, the Rules should retain the risk benchmark rating to A- or equivalent from S&P's, Moodys and Fitch.
- » The ENA also supports development of a retailer default fund as noted in our submission to the *Retailer-Distributor Credit Support Requirements Rule Change*.

The ENA would also like to point out that financial integrity of the NEM is not just limited to the prudential settlement and in some cases it is the network charges that have remained unpaid that has forced an insolvency official to be appointed and forced AEMO to declare an event. As such, the ENA would like to ensure that the AEMC:

- » expedites the COAG Energy Council Retailer insolvency costpass through Rule change (and equivalent Jemena Gas Networks Rule Change). This relates to the materiality issue raised above as well as clarifying the provisions to ensure that foregone revenue is included in the costs NSPs are able to recover in the cost pass-through amount; and
- » that the AEMC ensures that Clause 6B.A2.1 (Obligation to pay) of the Network Electricity Rules (NER) is retained in the Rules. This clause, which is also a conduct provision of the National Electricity Law (NEL), ensures that a retailer must pay to a NSP the network charges payable in respect of each shared customer by the due date for payment.

If further information is sought on this matter, please contact Ms. Kate Healey, Director Regulation, on 02 6272 1516 or by email on khealey@ena.asn.au.

Yours sincerely,



John Bradley
Chief Executive Officer