25 September 2014

Mr John Pierce
Chairman
Australian Energy Market Commission
Level 5, 201 Elizabeth St
Sydney NSW 2000

via website: submissions@aemc.gov.au

Dear Mr Pierce

EMO0024 – AEMC Market Review - NEM financial market resilience – response to Second Interim Report

Thank you for the opportunity to make a submission in response to EMO0024 – AEMC Market Review – NEM financial market resilience – Second Interim Report released on 14 August 2014.

The ENA notes that the second interim report includes draft recommendations which the AEMC considers will improve the ability of market arrangements to manage and respond to a market participant failure in the National Electricity Market (NEM).

Of particular concern to distribution network service providers (DNSPs) are the recommendations for changes to the ROLR involving firstly the time period before DNSPs can require increased credit support and secondly the treatment of very large customers.

Time period before DNSPs can require increased credit support should not be increased

The proposed changes involve shifting commercial risks from retailers to DNSPs. This proposal is inconsistent with the AEMC's strategic priority to develop market arrangements that encourage efficient investment and flexibility. Efficient investment does not occur when DNSPs (whether privately owned or government owned) are required to take on financial risks incurred by retailers.

Where changes in risk allocation are contemplated appropriate regulations should be included to protect the risk profile of all DNSPs in the NEM. Distribution and transmission businesses have a crucial role in the NEM with the largest sector investment (over $80b) and network/transmission charges which are a significant/material portion of an individual customer's bill (up to 50%).

The recommendation to provide "a minimum time of five weeks before DNSPs can require increased credit support from the designated ROLR as a result of its increased customer load (pp 113-115 of the report)" is a concern to the ENA. The increase to five weeks for provision of credit support increases the period where the DNSP may be exposed to financial loss or stress.

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DNSPs met with the AEMC on 30 July 2014 and discussed issues with the Frontier Economics report. The scenario analysis showed limited understanding of the real situation where a single DNSP can have over 50% of its business with a single retailer. For large retailers with a good credit rating, DNSPs may be fully exposed for a lengthy period without credit support, for example up to around 4 months without the ability to seek credit support. Where a DNSP may have one retailer with a 50% market share this would require a significant amount of working capital to be available to manage through this situation.

If there were to be failure of a large retailer, it would be expected that all retailers and many DNSPs would need significant (tens of millions of) dollars in working capital funding to manage through this period. The ability to immediately access bank and capital market debt at such a time would be very limited, which will place more financial stress on retailers and DNSPs. Any ROLR or insolvency event will have risks to DNSPs which will have flow-on impacts to cash flows and financing costs without adding further risk by delaying the ability to receive credit support. Ultimately these costs are born by all customers by some means. Any resilience framework needs to fully consider the DNSP issues also and ensure that any instability or non-payment in the market is managed quickly and efficiently.

This position is not helped by the fact that the three largest energy retailers each have a Standard & Poor's corporate credit rating which applies 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, some DNSP's experience is that a retailer (or retailers) within the group seeks 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 group of multiple credit allowances, resulting in the DNSP having no or inadequate ability to obtain credit support.

We contend therefore, that the assumption in the second interim report that a DNSP holds credit support in accordance with the credit support provision of the Rules prior to a ROLR event (allowing the DNSP to manage its cash flow) is not accurate. As a result, some DNSPs would need to borrow additional funds to meet the cash flow shortage, in some cases at, or around week five. This is likely to have adverse consequences in terms of DNSPs' future cash flows, credit rating and financing costs and increases the risk of financial contagion in the NEM. In addition, the impact on the DNSP's cost of capital within the context of the AER's 10-year trailing average cost of debt model would need to be addressed.

Given the above, we are concerned that the five week deferral decision has not been sufficiently justified in the second interim report, particularly in light of the reversal of the decision from the first interim report. Further, we do not believe that this report has addressed the analysis of DNSP submissions to the NEM financial resilience options paper which analysed the magnitude of the risks that could be transferred to DNSPs and the flow-on implications. If such analysis had been considered for the second interim report, it is unlikely that the AEMC would now make a five week deferral recommendation. We submit that the AEMC should consider the original analysis and evidence provided in the DNSP submissions and revise its recommendation on credit support arrangements to that of the first interim report.

Treatment of very large customers

The second concern is the proposed treatment of very large customers – defined as having an individual connection point consumption of over 10 GWh pa. The draft recommendation is that very large customers would need to arrange their own back-up retailer, preferably in advance. If a back-up retailer is not in place at the time of the ROLR event then the customer would be given a one week 'period of grace' to organise a back-up retailer and notify AEMO. If a back-up retailer is not notified to AEMO within 7 days of the ROLR event then the customer would be disconnected.

The obligation on a DNSP to disconnect these customers at short notice is onerous and impractical because of the processes that need to be followed and the resources necessary for the disconnection. The ENA is concerned as to which party is required to advise large customers of the consequences of not having a back up retailer and ensure customers have arranged for a back-up retailer to be engaged should the need arise. It may not be practical and the customer may frustrate the process of a DNSP disconnection which will only serve to leave AEMO with generator payment concerns and an inability to settle the market. The ENA are supportive of sharing the risks across the market participants, however it may be false comfort to expect that a large customer would assist or facilitate being disconnected through no fault of their own.

Our preferred option is that if the customer has not nominated a specific ROLR, then the customer should be allocated to the AER-appointed ROLR in line with current arrangements.

The ENA welcomes the opportunity to participate in the further development of this Review.
If you have any questions please contact me on 02 6272 1555 or Jim Bain on 02 6272 1516.

Yours sincerely

John Bradley
Chief Executive Officer

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