energy networks association

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Ms. Anne Pearson
Senior Director
Australian Energy Market Commission (AEMC)
PO Box A2449
Sydney South NSW 1235

National Electricity Amendment (Retailer – Distributor Credit Support requirements) Rule 2015 and National Gas Amendment (Retailer – Distributor Credit Support requirements) Rule 2015

Dear Ms. Pearson

The ENA welcomes the opportunity to make a submission to the AEMC in response to the retailer-distributor credit support requirements and the retailer insolvency cost-pass through provisions in the National Electricity Rules (NER) and the National Gas Rules (NGR) (together "the Rules") published by the AEMC on 22 October 2015.

The Energy Networks Association (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. ENA members own assets valued at over $100 billion in energy network infrastructure.

Summary of network sector views on rule change options

The ENA's preferred immediate option for implementation is *2.3, Strengthen existing arrangements: COAG Energy Council and Jemena proposals with enhanced credit support*. Network businesses are focused on achieving timely, practical improvements so that current arrangements better reflect the policy goals of promoting efficient management and allocation of risk, achieving resilient and predictable market arrangements for participants, and minimising costs to consumers.

ENA notes that the AEMC has developed two further options, including *Option 3 introducing a retailer default fund*. The ENA considers that a developed form of Option 3 would represent an optimal long-term approach, which would foster appropriate risk allocation and promote the long-term interests of consumers. As ENA has advised the Commission in discussions, detailed implementation of this option would need to be further developed to enable a full assessment of its costs and benefits. ENA member companies would be prepared to work with the AEMC to further develop this option.

Whilst the time to finalise the Rule change for this option could potentially be reduced by allocating much of the detail to the AER to determine in a Guideline, ENA does not consider this an appropriate approach.   A critical element of any robust credit support arrangements are that they are rules-based, designed on a clear ex ante basis, and that expectations of their implementation are well-aligned between market participants.

For this reason, ENA would strongly encourage the AEMC to focus on ensuring to the maximum extent possible that credit support requirements are transparently set out in a Rules framework as soon as possible and not left to substantive design and implementation through an AER Guideline process. The AER Guideline development process also would be an intensive exercise introducing further delays in overcoming the existing regime issues. Further ENA consider that there are potential broader impacts of these options in related parts of the Rules which will need careful analysis and potential drafting.

In ENA's view *Option 1: retain the existing arrangements* is not a viable option, as the current arrangements do not consider industry concentration measures to capture single name retailer concentration risk in the Rules. In addition the Rules are not explicit that credit allowances must be at parent entity level, so that retailers cannot receive multiple credit allowances. The Jemena Gas Networks (JGN) rule change proposal also sets out cogent reasons for amending the NGR to address shortcomings in the existing credit support framework.

Comment on proposed AGL rule amendments

In reviewing the proposed AGL rule change the ENA's primary concern is that any rule that lowers the benchmark such that a distribution network provider will never be entitled to credit support leaves the market unduly open to risks of financial contagion and systemic risk in the event of a retailer failure.

AGL proposes key changes to current arrangements, including:

- removing the Maximum Credit Allowance which means retailers have unlimited credit with distribution network service providers (DNSPs);
- shifting the Probability of Default benchmark from A- to BBB- which is barely investment grade rating; and
- changes the retailers required credit support amount calculation by introducing a new formula for credit support. Additionally, a retailer must be below investment grade (i.e. rated BB+ or lower) before credit support comes into play.

The effects of these rule changes for distribution networks would be:

- removing the Maximum Credit Allowance would mean an unlimited allowance - a DNSP could be substantially exposed to one retailer and that means concentration risk would not be addressed.
- lowering the Probability of Default benchmark means a DNSP would not be entitled to request credit support from any retailer rated BBB- or better, regardless of market share.
- the change in calculation, for example, means that under current rules and market share that a retailer (rated BBB-) who has provided a DNSP with credit support would no longer be required to provide any credit support.

The ENA does not support AGL's proposals as credit support arrangements are an appropriate risk management tool and should be part of the regulatory framework. The proposal does not address single-name concentration risk.

The ENA believes that the probability of default benchmark must remain at A- to avoid transferring risks from energy retailers to DNSPs. This promotes allocative efficiency because the risks are borne by those best placed to manage them. This promotes efficient investment in energy services in the long-term interests of energy customers.

The current Rules Table in Schedule 6B.1 (Clause 6B.B3.1) misaligns the Probability of Default (PD) of Dun & Bradstreet to Standard & Poor's and as a result gives unrated Retailers unrealistic credit allowances. In some cases unrated subsidiaries that use Dun and Bradstreet risk scores, and with a rated parent, may be assigned a higher Credit Allowance (CA) % than the parent. The Rules are unclear and we believe that this was not the intent of the credit arrangements in the NEM. The Dun and Bradstreet dynamic risk scores should be realigned with the ratings agencies in Schedule 6B.1 of NER as detailed in the table below.

S&P/Fitch	Moody's	Re-aligned Dun and Bradstreet
AAA	Aaa	
AA+	Aa1	
AA	Aa2	
AA-	As3	
A+	A1	
A	A2	
A-	A3	
BBB+	Baa1	
BBB	Baa2	
BBB-	Baa3	Minimal
BB+	Ba1	Very Low
BB	Ba2	Low
BB-	Ba3	Average
B+	B1	Moderate
B	B2	High
B-	B3	Very High
CCC	Caa	Severe
CC	Ca	
C	C	

Strengthening existing credit arrangement - AEMC Option 2.3

The ENA supports at minimum the early implementation of AEMC's Option 2.3 which would strengthen the existing arrangements, begin to address outstanding deficiencies in existing arrangements, and encompass the COAG Energy Council and Jemena proposals with enhanced credit support.

The ENA supports both elements of the COAG Energy Council and JGN retailer insolvency cost pass-through rule change, namely removing the materiality threshold, where one applies and clarifying the provisions to ensure that foregone revenue is included in the costs distributors are able to recover in the cost pass-through amount.

Option 2.3 assumes that the retailer insolvency cost pass-through provisions are implemented, the D&B probabilities of default are aligned to Standard & Poor's ratings, the maximum credit allowance may remain or could be removed and the current benchmark rating of A- is retained. That is, only retailers rated below A- may be required to provide credit support.

The AGL proposed rule change results in no credit support being required, even when a retailer with 45% market share is rated BB-.

The ENA believes the present Rules will be enhanced by correctly aligning the probability of default of D&B with those of S&P, Moodys and Fitch. The AEMC should work with D&B to realign the scores in the table to the S&P scores before issuing the Draft Determination.

With regard to multiple retailer authorisations the amendment would need 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.

The current credit support regime may be enhanced by improving the current calculation of maximum credit allowance which is set too high or removing the concept of the maximum credit allowance completely, however, the A- benchmark should be maintained.

The potential for contagion exists where a DNSP is exposed to one retailer in their network area with a very large market share, and additional credit support (concentration premium) would be required to adequately mitigate these risks.

Yours sincerely,

John Bradley
Chief Executive Officer