

15 July 2013

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

Dear Mr Pierce

RE: First Interim Report: NEM financial market resilience (Reference EMO0024)

The New South Wales (NSW) Distribution Network Service Providers, Ausgrid, Endeavour Energy and Essential Energy (the NSW DNSPs) are pleased to respond to the AEMC's First Interim Report on the resilience of the National Electricity Market (NEM) financial market (First Interim Report).

The NSW DNSPs support the focus of AEMC's First Interim Report on recommending measures to mitigate the risks of financial contagion following the financial distress of a large retailer. We recognise that this is an important piece of work given the potential flow-on effects to other energy market participants, and ultimately consumers, from a large retailer failing.

As noted in a previous submission by Ausgrid, current Retailer of Last Resort (RoLR) arrangements in NSW are unlikely to mitigate the flow-on impacts to distribution network service providers (DNSPs) from a large retailer failing. Perversely, the operation of current arrangements may exacerbate both the risk of financial contagion to market participants and the risk of a cascading retailer failure.

Consequently, the NSW DNSPs strongly support the AEMC's draft recommendations aimed at strengthening current RoLR arrangements. We agree with the AEMC's proposed changes to the RoLR scheme and consider that the proposed changes to credit support arrangements are well targeted and appropriate for mitigating the risk of a cascading retailer failure.

Further, we support the AEMC's decision not to recommend options aimed at amending DNSP credit support provisions or delaying the settlement period for the designated RoLR to pay DNSPs. As noted by the AEMC, these measures are likely to be of limited benefit in mitigating the risk of financial contagion. Rather, these options are likely to transfer significant risks to DNSPs and have a number of adverse flow-on effects.¹

The NSW DNSPs share the AEMC's view that there is merit in establishing a special administration regime. Whilst acknowledging the inherent complexity and difficulty involved in establishing such a regime, we consider that this would be an effective measure for mitigating both the flow-on impacts to other participants and also the risk of cascading retailer failure.

We note that the AEMC is currently of the view that some form of levy on network service providers (NSPs) under co-operative State laws is likely to be the most effective means for recovering any short fall in government funding for the regime.² The Allens Linklaters Report discusses several precedents that could be adapted to enable NSPs to recover any short fall

¹ In Ausgrid's previous submission, we identified that delaying the settlement period for paying DNSPs was likely to have adverse consequences upon DNSP's cash flows, credit rating and financing costs.

² AEMC, NEM financial market resilience, First Interim Report, 4 June 2013, p 47.

in government funding from the special administration regime (SAR Payment). These include:³

- The pass through mechanism contained in the National Electricity Rules (NER);
- The RoLR cost recovery regime under the National Energy Retail Law (NERL); and
- Jurisdictional schemes.

Whilst the NSW DNSPs generally agree with the high level features of the special administration regime, there are some comments we would like to make in relation to the proposed cost recovery mechanism for the regime.

Pass Through Mechanism

The NSW DNSPs are uncertain how the pass through mechanism could be adapted to recover the SAR Payment, given that this mechanism is only triggered if there is a positive (negative) change event, which materially increases (decreases) the cost of *providing direct control services* during a regulatory control period.⁴ Specifically, we are sceptical how the SAR Payment could be recouped via the pass through mechanism given that the payment has no correlation with a DNSP providing direct control services.

RoLR Cost Recovery Scheme

There may be merit in examining how the RoLR cost recovery scheme could be adapted to be used to recover the SAR Payment. The RoLR cost recovery scheme overcomes the issue noted above, regarding the SAR Payment not meeting the requisite requirements to qualify as a pass through event, by legislatively deeming the AER's distribution payment determination to be both a regulatory change event and positive change event.⁵

If this scheme were to be adapted, further consideration of how the scheme would be triggered is required. One possible solution would be for the special administrator to apply to the AER to make a distribution payment determination to recover the SAR Payment. The AER would then be tasked with determining the amount that should be recovered and which DNSPs are to make payments as part of the cost recovery for the scheme.

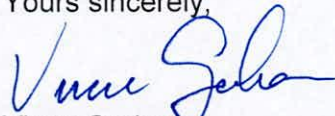
Jurisdictional Schemes

The establishment of jurisdictional schemes in each of the NEM participating States is also a viable option. However, as the failed retailer is likely to operate across multiple jurisdictions, consideration will need to be given to how this scheme is triggered and by whom, as well as how DNSPs payment obligations are determined.

The NSW DNSPs understand that it will take some time to develop and implement a special administration regime. We look forward to working with the AEMC in achieving this goal and hope to continue engaging with the AEMC on the development of an appropriate cost recovery mechanism.

If you have any queries or wish to discuss further please contact Mike Martinson, Group Manager Regulation at Networks NSW on (02) 9249-3120 or via email at michael.martinson@endeavourenergy.com.au

Yours sincerely,



Vince Graham

Chief Executive Officer

Ausgrid, Endeavour Energy and Essential Energy

³ The Allens Linklater Report, *Dealing with Financial Distress in the National Electricity Market: Special Administration Regime for Electricity Retailers*, 10 May 2013, pp37-41.

⁴ Refer to 6.6.1(a) and (b) of the NER. See also 10 of the NER, definition of a positive (negative) change event.

⁵ Refer to section 167 of the National Energy Retail Laws.