Ministerial Council on Energy

Standing Committee of Officials Bulletin No. 192

The National Energy Customer Framework – Credit Support Settings

The National Energy Customer Framework (NECF) incorporates amendments to the National Electricity Rules (NER) and National Gas Rules (NGR) providing regulated financial arrangements between distributors and authorised retailers[1]. A key part of these arrangements is the provision of financial guarantees by retailers against outstanding network charges, that may be drawn upon by distributors in the event of a retailer defaulting on these payments. This is known as 'credit support'.

The purpose of this bulletin is to provide stakeholders with information on the NECF credit support arrangements, including what changes were made to the regime in the Rules published in November 2010 (available from www.mce.gov.au).

The purpose of the credit support arrangements is to manage the risk to energy customers from retailer default on network charges as customers are ultimately exposed to this risk, because distributors may pass on unrecovered network charges to customers. The NECF credit support arrangements are designed to require a fair and proportional level of credit support from retailers, taking into account their credit rating (which indicates the risk of a retailer defaulting) and their market share in a given distribution area (which determines the magnitude of the risk to customers from such a default).

This is effected by providing each retailer a credit allowance, which is a reduction in the amount of credit support they must provide against their full outstanding network charges. The retailer's credit allowance may – at most – be equal to a proportion of the distributor's total annual retail charges (TARC) called the maximum credit allowance (MCA). The amount of a retailer's credit allowance as a proportion of the MCA is reduced for progressively lower credit ratings[2], according to a table set out in the new Retail Support Rules.

This regime was proposed in the second exposure draft of the NECF which was released in November 2009 for consultation, based on a similar regime implemented by the Victorian Essential Services Commission in 2006.

As an outcome of consultation on this proposal, a number of changes were made to the credit support arrangements, including:

- Nomination of selected provisions as conduct provisions enforceable by the parties against each other.
- Strengthening of some provisions providing for the enforceability of the regime.
- Providing for resolution of disputes through Part 15C of the NGR and Chapter 8 of the NER.
- Clarifying the circumstances in which distributors may pass through unpaid network charges to customers.
- Commissioning a review of the table of credit allowance percentages to ensure they were based on the most recently available default risk data from credit ratings agencies.

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[1] National Electricity (Retail Support) Amendment Rules 2010 and National Gas (Retail Support) Amendment Rules 2010

[2] Also, Dun and Bradstreet Dynamic Risk Scores (DRS).

In respect of the review of the table of credit allowance percentages, commercial data on default risks associated with different credit ratings showed that the default risk for higher investment grade ratings had deteriorated since 2006, while low (and Dun & Bradstreet DRS) ratings had improved significantly.

A revised table of credit percentage allowances which factors in the new commercial data while leaving the other credit support settings unchanged, would have led to a substantial decrease in the probability of lower rated retailers being required to provide credit support, and a mild increase in the probability of higher rated retailers being required to do so.

It was considered, however, that in the light of changes in the broader economy due to the global financial crisis, and more volatile energy market conditions as signalled by both the occurrence of National Electricity Market administered prices and the increased number of spot price events above $5,000 per MWh, it would be inappropriate to substantially reduce the level of insurance that distributors hold against the risk of default by lower rated retailers. Instead a solution was adopted which enhances the protection of end users against default events generally. To this end, the MCA was altered from 33% of a distributor's total annual retailer charges (as proposed in the second exposure draft) to 25%, which reduces the MCA available and has the effect of requiring credit support to be provided by retailers with a smaller market share than would otherwise be the case.

While this will have the effect of requiring retailers in some distribution areas to provide credit support where previously they have not done so (with associated costs), this must be weighed against the ultimate costs borne by customers in the event of a retailer default.

It is noted that a lower MCA is compatible with a maturing market, where retailer market share is increasingly evenly spread. The credit support arrangements provide a positive incentive on retailers to spread their customer base as widely as possible rather than become geographically concentrated. This reduces the cost of the regime while moderating risk to customers and promoting competition in the energy markets.

This policy decision was conveyed in the response to stakeholder submissions published by the Standing Committee of Officials in September 2010.

MCE Standing Committee of Officials
12 May 2011