

14 August 2009

Manager MCE Secretariat
Department of Energy Resources and Tourism
GPO Box 1564
Canberra ACT 2601



Dear Sir / Madam

Survey of Second Tier Retailers

ENERGEX Limited (ENERGEX) welcomes the opportunity to respond to the *Survey of Second Tier Retailers Report* (Report) by the Financial Markets Working Group established under the Ministerial Council on Energy's (MCE) Standing Committee of Officials (SCO). ENERGEX provides the following comments as a Distribution Network Service Provider (DNSP) operating in Queensland.

ENERGEX notes that the feedback provided in response to the Report will be provided to the work streams involved in the development of the National Energy Customer Framework (NECF). ENERGEX supports the efforts being made by the MCE SCO in relation to the development of a national regime for credit support between retailers and distributors as well as a Retailer of Last Resort scheme under the NECF framework.

Importance of DNSP Prudentials

Credit support arrangements are a fundamental part of the regulated retailer/distributor relationship, providing an important prudential underpinning for significant financial risks to the market. As part of the NECF discussions, the SCO commented that DNSPs should be entitled to require credit support from certain retailers to enable them to manage their risk of exposure to non-payment for services by a retailer, particularly as a distributor cannot refuse to provide such services.

DNSPs are required to provide distribution services whether or not they are paid by the retailer. This presents a real and substantial financial risk to a DNSP and therefore to the electricity market generally. As a monopoly supplier of services, DNSPs play a critical role in ensuring that end users receive electricity.

The services that DNSPs provide are therefore similar to those provided by AEMO in balancing market transactions, because as the market operator, AEMO is providing a monopoly service, ensuring the integrity and security of the market. However, unlike DNSPs, AEMO has effective prudential safeguards in place to assist in managing the risk of a defaulting market participant.

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Retailers can stop paying distribution charges and / or refrain from providing credit support, while remaining registered market customers and continuing to attract and transfer new customers. Therefore, electricity distributors are obliged to provide customer connection services as well as continue providing retailers with support services, without being able to terminate their services, prevent further transfer of new customers or take any other steps to limit their exposure, while the size of distributors' credit exposure continues to grow.

Queensland Prudential Requirements

Under section 55I of the *Electricity Act (Qld)* (the Act), a retailer operating in Queensland is deemed to have entered into the Standard Coordination Agreement (SCA) with a DNSP, unless a negotiated coordination agreement has been entered into separately. The SCA is annexed to the Queensland Electricity Industry Code.

Clause 12 of the SCA outlines the terms and conditions for when a DNSP may request the retailer to provide performance security and also provides that a DNSP may request an unconditional undertaking in a form agreed between the parties (but failing agreement in the same form as used by AEMO). The amount of the undertaking requested by ENERGEX, is in accordance with the SCA.

The Report specifically refers to DNSP prudentials and comments that most DNSPs in NEM jurisdictions impose a minimum prudential requirement on new entrants and before the first customer is acquired. In the Report, retailers commented that Queensland and South Australia were the least flexible in the enforcement of prudentials.

In response to those comments, it should be noted that ENERGEX operates in accordance with the jurisdictional regulatory requirements and does not request a prudential guarantee unless the conditions specified under the deemed SCA are met, and not until the first customer transfer is effected. In determining the required amount of guarantee, ENERGEX requests the retailer's input in relation to the estimate of customer transfers. Otherwise, in the case of established retailers, ENERGEX calculates the prudential guarantee amount based on the previous three months' network charges.

Credit Insurance

The Report makes mention of the possibility of utilising credit insurance as a type of DNSP prudential guarantee. ENERGEX understands that credit (or debtors) insurance is a form of insurance offered by private insurance companies to businesses to protect their accounts receivable assets from loss due to credit risks such as default on payment or insolvency.

ENERGEX has been investigating the terms and conditions surrounding credit insurance together with the availability based on current Queensland arrangements. Importantly, credit insurance is provided for a 'book' of retailers, rather than individual retailers. This enables the insurer to better spread its own risk and allows increased flexibility when establishing the level of cover that is provided. Also, an insurer need not accept all retailers proposed for inclusion in the 'book'. ENERGEX has discovered that the risk appetite of insurers varies significantly, both as to type (e.g. size and level of perceived risk) and the number of retailers that will be accepted for credit insurance purposes. Once a premium is determined, it would then be allocated by the DNSP to the retailers included in the 'book'.


Therefore, an important qualification that needs to be considered with regards to credit insurance involves its availability to all retailers as well as the ability of insurers to withdraw cover at any time.

Conclusion

ENERGEX is willing to consider requests from retailers for flexible arrangements in terms of DNSP prudential requirements. However, DNSPs provide an essential service and similar to AEMO have an important role to play in the ongoing integrity of the electricity market and as such, credit support and prudential requirements must provide DNSPs with adequate responses and / or penalties to address defaulting retailers.

Should the MCE SCO have any further questions in relation to the comments raised in this submission, please do not hesitate to contact me directly on (07) 3407 4161.

Yours sincerely

A handwritten signature in black ink, appearing to read 'L. R. Dwyer', with a small dot at the end of the line.

Louise Dwyer
Group Manager Regulatory Affairs