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18th June 2010

Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

By email: electricity@qca.org.au

Re: Review of Electricity Retailer & Distributor Credit Support Arrangements

Australian Power & Gas (APG) welcomes the opportunity to provide comments on the Queensland Competition Authority (QCA) consolation notice on the review of electricity retailer and distributor credit support arrangements.

At the outset we would strongly recommend the QCA review and give careful consideration to adopting the credit support provisions that are contained in the Victorian Electricity default Use of System Agreement (UoSA). The Essential Services Commission of Victoria (ESC) conducted considerable consultation on the issue of credit support. The credit support provisions currently included in the Default UoSA provide an equitable balance between distributor risk mitigation and retailer cost.

The expansion of the acceptable methods in assessing the risk level of retailers and subsequent potential exposure to distributors from non payment of network charges has been a significant positive step in not only removing barriers to market entry but also removing barriers to market expansion for small new entrant retailers operating in Victoria. This positive step aids retailer market expansion which equates to consumer benefit through enhanced competition. It should also be noted that similar credit support arrangements exist in both South Australia and the UK.

In reviewing the credit support arrangements consideration must be given to the role the retailer plays in the supply chain and the inherent risks they face. Retailers provide the conduit for passing through and collecting the network charges from the end consumer on behalf of the distributor. Regardless of whether the retailer is able to recover these costs from the end consumer, they remain liable to the distributor for the charges. Currently there is no appropriate consideration of this risk factored into determining the appropriate amount of credit support. The provision whereby a distributor may request an amount of credit support up to three months of estimated distributor charges is premised on the basis that a retailer fully recovers the network charges from its end use customers; which inevitably is not the case.

If the QCA does not propose to make revisions to the credit support arrangements that would bring those in QLD in line with those currently operating in the Vic Electricity default UoSA (and those operating in SA and the UK), then the QCA must introduce a mechanism whereby the risk faced by retailers in not being able to recover network costs from end use customers is factored in to determining the allowable amount of credit support that distributors may request from retailers.

APG is of the firm view that the existing credit support obligations that exist in the QLD energy market and the narrow methods in which retailers have available to meet their obligations act as barriers to market entry and expansion. This is especially the case for smaller new entrant retailers.

In particular there is a premise that credit support arrangements are able to be negotiated. In our experience this is far from the case. APG has on previous occasions requested distributors to look at a suite of options in meeting credit support obligations, only to be met with refusal and indifference to any option other than an unconditional undertaking / bank guarantee.

The QCA in looking to set guidelines for credit support must ensure there is a greater ability for retailers to negotiate with distributors on the form of credit support. In our view there are a number of innovative options to meet credit support arrangements that will provide distributors with the ability to mitigate risk and not place a substantial financial burden on retailers.

Retailers must be permitted to nominate alternative forms of credit support and where such alternatives provide equivalent credit assurance, distributors must not unreasonably withhold consent for their use.

Our detailed comments are contained in the following attachment. APG would be happy to further discuss our experiences in dealing with distributors and credit support with the QCA. Should you wish to discuss any aspect of our submission I may be contacted on (02) 8908 2714 or via email at sruddy@auspg.com.au

Yours Sincerely

Shaun Ruddy
Manager Regulatory & Compliance
Australian Power & Gas

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Review of Electricity Retailer and Distributor Credit Support Arrangements

Trigger Mechanism

The consultation notice makes note of the following trigger mechanisms, and questions whether these mechanisms are too easy or difficult for a distributor to activate. The trigger mechanisms where a distributor may request a retailer to provide credit support are where the retailer,

(a) Does not have, or has an unacceptable credit rating,
(b) Has consistently failed to pay their bills by the due date,
(c) Has defaulted under the National Electricity Rules,
(d) Has ceased to be registered with AEMO, or
(e) Has purchased energy from someone who issued the retailer a default notice.

APG holds the view that the trigger mechanisms are too easy for a distributor to activate. For example, in the case of a small new entrant retail supplier that may not be in a position to obtain an acceptable credit rating however pays all their bills by the due date. Regardless, the distributor may still request the retailer to provide credit support, which as it currently stands would be in the form of an unconditional undertaking / bank guarantee.

Until such time as the retailer obtains an acceptable credit rating, they would have to continue to maintain ever increasing levels of credit support regardless of continually paying their bills by the due date.

One way in which APG have attempted to address this disparage with distributors is through offering to pay a proportion of the estimated network bills in advance, however such a proposal has been rejected. Other options we have put to distributors include the use of insurance based products which again have met with refusal by the distributors. This further highlights the retailer's inability to negotiate outcomes with distributors on the issue of credit support. An issue that we believe must be addressed.

The credit rating issue has been substantially addressed in the Victorian Electricity default UoSA where alternative methods of assessing the risk level of retailers have been included. As previously stated we would recommend the QCA review the Victorian arrangements with the view to implement similar provisions.

Form and Provider of Credit Support

The authority has asked whether unconditional undertakings issued by a bank are the most cost effective means of providing a guarantee. APG is firmly of the view that unconditional undertakings by banks are NOT the most cost effective means of providing a guarantee.

Credit support is provided on the basis that it provides a distributor with a method of managing potential risk from non payment of network charges. The key issue here is risk management or mitigation for the distributor. It is our view that an unconditional undertaking is only one of a number of options available that allow distributors to manage or mitigate the potential risk of non payment of network charges.

The unconditional undertaking is an extremely costly exercise for smaller new entrant retail suppliers. For smaller new entrant retail suppliers unconditional undertakings issue by a bank are generally required to be “cash backed”. That is working capital that would be otherwise used to grow and develop the business is tied up in support of the unconditional undertaking. For a smaller retailer that has entered the market and is seeking to expand the cash outlay required to support the unconditional undertaking will ever increase proportionately to its growth in customer numbers and increased load.

If a smaller retailer gets to the point where there is no longer working capital available to support the increased level of unconditional undertaking (and they have not been able to obtain a suitable credit rating) the only option available to the retailer is to halt its growth and expansion activities until sufficient capital is found to support the increased level of unconditional undertaking. Worst case scenario it may force the retailer to withdraw from the market altogether.

Previously APG has made proposals to distributors on a number of more cost effective options for meeting credit support obligations. In our view these options are not only cost effective they also provide equitable levels of credit assurance. These include;

- Insurance product options,
- Proportional pre-payment of network bills,
- Adoption of the Dun & Bradstreet Dynamic Delinquency Score (DDS) & Dynamic Risk Score (DRS) in assessing retailer risk.

Flexibility must be built in to the options available to retailers in meeting credit support obligations. Where other alternatives (to unconditional undertakings) exist which provide the same level of credit assurance, retailers should be able to opt for these options and distributors should not be able to unreasonable withhold consent for their use.

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Amount of Credit Support

The current level of credit support required in the Queensland market creates an unreasonable barrier for new entrant retailers seeking to expand their market share. Whilst some may argue that credit support does not create a barrier to market entry, the significant impact felt by retailers from credit support requirements arises as the retailer begins to acquire market share.

As a retailer acquires market share (and load) the amount of credit support a retailer is expected to post increases. For a new entrant retailer that is yet to achieve an acceptable credit rating the only form of credit support available is that of an unconditional undertaking, generally one that is “cash backed”.

So where a retailer is successful in increasing it’s market share, it is also exposed to ever increasing credit security amounts.

To elevate the barrier to expansion issue the QCA must include in the guideline the provision for the retailer to meet their obligation through other options, including the provision whereby a distributor cannot unreasonably withhold consent to the use of alternative options where it is shown the alternative options provide the same level of credit assurance to the distributor.

We would again recommend the QCA review the Victorian Electricity default UoSA credit support provisions.

Credit support is required by distributors so they may mitigate the potential risk from non payment of network charges by the retailer. The role retailers play in the supply chain is one where they act on the behalf of the network in passing on and recovering the network cost from the end consumer. In the process of determining the amount of credit support no consideration is given to the issue that a retailer may not be able to recover the network charge form the end consumer. However they remain liable to the distributor for this charge regardless of whether they have been able to recover it from the end consumer.

The determination that an acceptable credit support amount should not exceed three months of estimated distributor charges is premised on the assumption that the retailer has been able to recover all passed on network charges from the end customer. This is often not the case.

As previously stated if the QCA does not propose to make revisions to the credit support arrangements that would bring those in QLD in line with those currently operating in the Vic Electricity default UoSA (and those operating in SA and the UK), then the QCA must introduce a mechanism whereby the risk faced by retailers in not being able to recover network costs from end use customers is factored in to determining the allowable amount of credit support that distributors may request from retailers.

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Review of Credit Support

The triggers for the review / release of credit support must be structured in a way that a retailer may request the review at any time where it can demonstrate that the triggers for requiring credit support no longer exist. Further review / release provisions must place an obligation on the distributor that they cannot unreasonably refuse the request from the retailer for the review and release.

General Issues

The QCA has asked whether the current credit support arrangements reflect best practice. As we have stated previously in our submission we would strongly recommend the QCA review the arrangements that are in use in Victoria, South Australia and the UK.

We believe that the arrangements that are in place in these jurisdictions are more representative of a best practice approach to credit support.